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Supreme Court, U.S.
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No. 11-____

IN THE

Supreme Court of the United States

DOMINIC F. AMOROSA and CHRISTOPHER GRAY,

Petitioners,

v.

ERNST & YOUNG LLP,

Respondent.

On Petition For A Writ of Certiorari to the United States Court of Appeals for the Second Circuit

PETITION FOR A WRIT OF CERTIORARI

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May 3, 2011

QUESTIONS PRESENTED

1. Whether a plaintiff who purchased and later held securities in reliance on alleged misrepresentations and omissions by defendant, can maintain a "holder" claim under the federal securities laws in light of *Dabit v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 126 S.Ct. 1503, 1513, 164 L.Ed.2d 179 (2006), which held that the statutory phrase "in connection with the purchase or sale of a covered security" was broad enough to apply to any fraudulent conduct that *merely coincides with* a securities transaction (*Dabit*, 126 S. Ct. at 1514 [Emphasis supplied]), notwithstanding that the lower courts have previously interpreted the nearly identical statutory phrase "in connection with the purchase or sale of any security" in Rule 10b-5 far more restrictively to prohibit an action by a "holder." *Cf.*, *Blue Chip Stamps*, 421 U.S. 723, 737-738, 95 S.Ct. 1917, 1926 (1975) ("in connection with" purchase or sale of security language was not broad enough to cover persons *who never dealt in the subject security* (but this Court's holding did not address fact pattern where plaintiff *in fact purchased* and later held stocks based on misrepresentations)).

2. In the context of a complex multidistrict securities litigation assigned to a single federal judge, whether a plaintiff's individual state law claims are preempted by the Securities Litigation Uniform Standards Act of 1998 ("SLUSA") notwithstanding that plaintiff's individual "opt-out" case did not seek relief on behalf of more than 50 persons and was not consolidated or jointly prosecuted with the

class action or any other opt-out actions, and therefore did not fall within the statutory language defining a preempted "covered class action."

3. Whether the loss causation element of a claim under Section 10(b) of the Securities Exchange Act can be satisfied in the context of a claim against an auditor by pleading that plaintiff suffered losses when information concerning the accuracy and integrity of the issuer's reported financial results was revealed, resulting in statistically significant drops in the issuer's share price that were unexplained by market factors or other non-issuer specific events.

PARTIES TO THE PROCEEDINGS BELOW

The petitioner Dominic F. Amorosa was plaintiff and appellant below. Petitioner Christopher J. Gray was nonparty appellant below.

The respondent (defendant and appellee below) is Ernst & Young, LLC.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
PARTIES TO THE PROCEEDINGS BELOW	iii
TABLE OF APPENDICES	v
TABLE OF AUTHORITIES	vi
INTRODUCTION	1
OPINIONS BELOW	4
JURISDICTION	4
STATUTES INVOLVED	4
STATEMENT OF THE CASE	7
REASONS FOR GRANTING THE WRIT	13
A. The Court Should Grant the Petition Because Courts' Interpretations of Two Near-Identical Statutory Phrases Concerning Misstatements "In Connection With" The Purchase or Sale of Securities With Respect to "Holder" Claims Are Significantly Inconsistent	13

Page

B. This Court Should Carry Out the Clear Intent of Congress by Clarifying that Individual Securities Lawsuits Are Not Pre-empted By SLUSA 18

C. The Court Should Grant the Petition to Clarify What is Required to Plead Loss Causation Against Auditors, A Recurring Question that Has Led To Widely Divergent Case Law in the Circuit Courts..... 22

CONCLUSION..... 25

TABLE OF APPENDICES

Summary Order of the Court of Appeals for the Second Circuit, dated February 2, 2011 ..... 1a

[Corrected] Decision and Order of the U.S. District Court, Southern District of New York, dated January 20, 2010 ..... 13a

TABLE OF AUTHORITIES

Page(s)

Cases

Alaska Elec. Pension Fund v. Flowserve Corp.,
572 F.3d 221 (5th Cir. 2009) 4, 22

Birnbaum v. Newport Steel,
193 F.2d 461 (1952) 16, 17

Blue Chip Stamps v. Manor Drug Stores,
421 U.S. 723, 95 S.Ct. 1917 (1975) 2, 16, 17

Castellano v. Young & Rubicam,
257 F.3d 171 (2d Cir. 2001) 4, 22

Dabit v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 126 S.Ct 1503, 164 L.Ed.2d 179 (2006) .....*passim*

Dura Pharmaceuticals, Inc. v. Broudo,
544 U.S. 336 , 125 S.Ct. 1627,
161 L.Ed.2d 577 (2005).....*passim*

In re Alger, Columbia, Janus, MFS, One Group, Putnam Mut. Fund,
320 F. Supp. 2d 352 (D. Md. 2004) 17

In re AOL Time Warner Inc. Sec. Litig.,
No. 02-CV-5575, 2006 WL 903236 ..... 2, 18

In re Bear, Stearns Cos. Sec. Derivative and ERISA Litig., No. 09-CV-778, 08-MDL-1963,
2009 BL 252494 (S.D.N.Y. Nov. 13, 2009) 3, 19

In re Worldcom Inc. Sec. Litig.,
308 F. Supp. 2d 236 (S.D.N.Y. 2004)..... 2, 18

Page(s)

Indiana State District Council v. Omnicare, Inc., 583 F.3d 935 (6th Cir. 2009)..... 3, 22

SEC v. Zandford, 535 U.S. 813, 122 S.Ct. 1899, 153 L.Ed.2d 1 (2002)..... 16

Sherman v. Bear Stearns Cos. Inc., S.D.N.Y. Dkt. No. 09-CV-8161 (RWS)..... 2, 19

Superintendent of Ins. Of N.Y. v. Bankers Life & Casualty Co., 404 U.S. 6, 92 S.Ct. 165, 30 L.Ed.2d 128 (1971) 16

Tricontinental Inds. Ltd. v. Pricewaterhouse Coopers, LLP, 475 F.3d 824 (7th Cir. 2007) 4, 22

U.S. v. O'Hagan, 521 U.S. 642, 117 S.Ct. 2199, 138 L.Ed.2d 724 (1997)..... 16

Statutes

15 U.S.C. § 78bb(f)(1) .....*passim*

15 U.S.C. § 78bb(f)(5)(B).....*passim*

15 U.S.C. § 78j(b).....*passim*

28 U.S.C. § 1254(1) 4

Pub. L. No. 105-353, § 2(5)..... 21

INTRODUCTION

Petitioners Dominic F. Amorosa ("plaintiff" or "Amorosa") and Christopher J. Gray respectfully petition for a writ of certiorari to the United States Court of Appeals for the Second Circuit. The Petition presents two significant questions of law concerning an "opt-out" securities plaintiff's right to pursue individual claims under the Securities Exchange Act and/or state law. In the case at bar, these claims arose in connection with an individual "opt-out" action that was assigned to the same district judge as numerous other cases arising out of the AOL Time Warner accounting fraud as part of a sprawling multidistrict litigation involving well over 100 cases—an increasingly common procedural posture that can raise difficult questions about the rights of private plaintiffs who choose to purse their own individual "opt-out"claims and not participate in the class action. The Petition also presents the vexing and frequently-recurring question of what is required to state a claim for loss causation against an auditor in the context of an auditor's misstatements and omissions of fact alleged to be in violation of the Securities Exchange Act of 1934.

First, the Petition presents the question of whether the plaintiff, who purchased and later held AOL Inc. common stock based on alleged misrepresentations and omissions by defendant, can maintain a "holder" claim under the federal securities laws in light of *Dabit v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 126 S.Ct 1503, 1513, 164

L.Ed.2d 179 (2006), which held that the meaning of the statutory phrase "in connection with the purchase or sale of a covered security" applies to any fraudulent conduct that *merely coincides with* a securities transaction. *Dabit,* 126 S. Ct. at 1514 [Emphasis supplied]. *Cf., Blue Chip Stamps,* 421 U.S. 723, 737-738, 95 S.Ct. 1917, 1926 (1975) ("in connection with" purchase or sale of security language was not broad enough to cover persons who never dealt in the subject security).

Second, the Petition presents the question of whether a plaintiff's common law claims are preempted by the Securities Litigation Uniform Standards Act of 1998 ("SLUSA") where plaintiff's case did not seek relief on behalf of more than 50 persons and was not "joined, consolidated, or otherwise proceed[ing] as a single action for any purpose" with any other actions. In fact, plaintiff's case was the only remaining action arising out of the AOL Time Warner accounting fraud at the time it was dismissed as preempted by SLUSA. The scope of remedies available to individual "opt out" plaintiffs in the context of a multidistrict litigation is a recurring one that has arisen with increasing frequency in recent MDLs. *See, e.g., In re Worldcom Inc. Sec. Litig.*, 308 F. Supp. 2d 236, 246 (S.D.N.Y. 2004) *In re AOL Time Warner Inc. Sec. Litig.*, No. 02-CV-5575, 2006 WL 903236 At *1, n.2 (S.D.N.Y. Apr. 6, 2006); *Compare Sherman v. Bear Stearns Cos. Inc.*, S.D.N.Y. Dkt. No. 09-CV-8161 (RWS) (district court granted large opt-out's plaintiff's objection to consolidation due in part to concern

that if the case were consolidated with class action, certain claims would be preempted) with *In re Bear, Stearns Cos. Sec. Derivative and ERISA Litig.*, No. 09-CV-778, 08-MDL-1963, 2009 BL 252494 (S.D.N.Y. Nov. 13, 2009) (denying opt-out plaintiffs' motion to not have their case consolidated with class action). Further, the decisions below result from statutory interpretation that strays far from the plain statutory language of SLUSA and instead attempts to carry out what a court perceives to be the purpose of Congress in enacting the legislation. This Court should grant this Petition to clarify that SLUSA's preemption language means exactly what it says- that actions that are joined, consolidated or proceeding as a single action are preempted, and strictly individual actions that merely arise out of the same general fact pattern as other cases are not.

Third, and finally, this Petition presents the frequently-recurring question of what is required to state a claim for loss causation against an auditor in the context of the Exchange Act. This question has divided the lower courts and produced contradictory case law because alleged misstatements by auditors are frequently not the subject of a "mirror image" or "I'm a liar"-style corrective disclosure. The Circuit Courts of Appeals have enunciated varying and inconsistent standards for pleading loss causation in this frequently-arising factual context. *Compare* case at bar (Appendix, pp. 7a-8a, 46a-48a) *with Indiana State District Council v. Omnicare, Inc.*, 583 F.3d 935 (6th Cir.

2009) *Tricontinental Inds. Ltd. v. Pricewaterhouse Coopers, LLP*, 475 F.3d 824 (7th Cir. 2007); *Alaska Elec. Pension Fund v. Flowserve Corp.*, 572 F.3d 221, 233 (5th Cir. 2009); *Castellano v. Young & Rubicam*, 257 F.3d 171, 186 (2d Cir. 2001).

OPINIONS BELOW

The unreported opinion of the United States Court of Appeals for the Second Circuit is reproduced in the Appendix at 1a-12a. The unreported corrected decision of the United States District Court for the Southern District of New York is reproduced in the Appendix at 13a-77a.

JURISDICTION

The Court of Appeals' judgment was entered on February 2, 2011. This Court has jurisdiction under 28 U.S.C. 1254(1).

STATUTES INVOLVED

The Securities Exchange Act of 1934 ("Exchange Act") Section 10(b) provides as follows:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> * * *

> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b).

The Securities Litigation Uniform Standards Act of 1998 ("SLUSA") provides in part as follows:

> **(f) Limitations on remedies**
>
> (1) Class action limitations
>
> No covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging—
>
> (A) a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security; or
>
> (B) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security.

15 U.S.C. §§ 78bb(f)(1).

SLUSA further provides in part as follows (defining statutory term "covered class action"):

> (B) Covered class action
>
> The term "covered class action" means
>
> (I) any single lawsuit in which
>
> (I) damages are sought on behalf of more than 50 persons or prospective class members, and questions of law or fact common to those persons or members of the prospective class, without reference to issues of individualized reliance on an alleged misstatement or omission, predominate over any questions affecting only individual persons or members; or
>
> (II) one or more named parties seek to recover damages on a representative basis on behalf of themselves and other unnamed parties similarly situated, and questions of law or fact common to those persons or members of the prospective class predominate over any questions affecting only individual persons or members; or
>
> (II) any group of lawsuits filed in or pending in the same court and involving common questions of law or fact, in which
>
> (I) damages are sought on behalf of more than 50 persons; and

> (II) the lawsuits are joined, consolidated, or otherwise proceed as a single action for any purpose.

15 U.S.C. § 78bb(f)(5)(B).

STATEMENT OF THE CASE

By 1999, prior to Amorosa's purchase of AOL[1] shares, AOL was engaged in an accounting fraud under which it actually provided the funds to its purported customers to purchase online advertising from AOL through "barter," "swap," or "round-trip" deals.[2] Further, by early 2000 AOL was utilizing a blatantly non-GAAP method of accounting for its European subsidiary AOL Europe under which it did not consolidate the financial results of AOL Europe with AOL's own financial results.

AOLTW's independent auditor during the entire relevant period was defendant Ernst & Young, LLC ("E&Y"). E&Y offered a "clean" audit opinion on AOL's reported financial results for the annual period ended June 30, 1999 ("6/30/99 opinion").

On January 10, 2000, AOL and Time Warner announced that AOL would acquire Time Warner, subject to shareholder approval.

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[1] AOL Inc., the predecessor to AOL Time Warner, Inc., is hereinafter referred as AOL. Together with its successor firm it is sometimes referred to as AOLTW.

[2] The facts herein are as pleaded in the Second Amended Complaint, the operative complaint herein at the time of the dismissal below and the complaint *sub judice* in the Court of Appeals.

Amorosa acquired all but 330 shares of his eventual position of 16,330 pre-merger AOL shares *in the ensuing week after the announcement of the merger during January 2000*, at artificially inflated prices of between $61.89 and $65.88 a share. In making his purchases Amorosa affirmatively relied upon, *inter alia*, AOL's reported financial results.

In connection with the Merger, defendants filed and disseminated to shareholders a Joint Proxy and Merger Registration Statement ("Merger Registration Statement" or "MRS") which included AOL's false financial statements and E&Y's clean audit opinion concerning same.

The Merger Registration Statement incorporated the following documents by reference:

a. All documents filed by AOL or Time Warner with the SEC "after the date of this joint proxy statement-prospectus and before the date of each company's special meeting."

b. AOL's Annual Report on Form 10-K for the fiscal year ended 6/30/99.

c. AOL's Quarterly Reports on Form 10-Q for the quarterly periods ended 9/30/99, 12/31/99, and 3/31/00.

d. AOL's Report on Form 8-K dated 12/1/99.

e. AOL's Reports on Form 8-K dated 12/21/99, 1/10/00, 1/19/00, 3/17/00, 4/3/00, and 4/18/00.

AOL's 1999 annual results were audited and certified by E&Y, while AOL's interim results were reviewed and approved by E&Y. These reported financial results were incorporated by reference in the MRS.

The Merger Registration Statement also reported that America Online and German media company Bertelsmann had announced an agreement to restructure their interests in the AOL Europe and AOL Australia joint ventures. AOLTW would subsequently admit that this restructuring should have resulted in AOL consolidating its AOL Europe results, beginning in 3/00, and has restated its 2000 and 2001 financials, reducing 2000 Operating Income from $1.76 billion to $1.46 billion.

The Merger Registration Statement contained the "clean" unqualified audit opinion of E&Y, certifying that E&Y had audited AOL's annual financial statements for the years ended 6/30/97, 6/30/98 and 6/30/99 in accordance with Generally Accepted Auditing Standards ("GAAS") and that those financial statements fairly presented AOL's financial results in accordance with Generally Accepted Accounting Principles ("GAAP").

Under the accounting standard AU 711 this "clean" opinion was knowingly false and misleading when issued because the opinion constituted an affirmation that E&Y was not aware of any deviation from GAAP in E&Y's previously-issued quarterly financial statements (as well as the 6/30/99 opinion). At the time that E&Y gave the clean opin-

ion for the MRS, it already knew that AOL was applying non-GAAP accounting in not consolidating AOL Europe's financial results pursuant to the Bertelsmann agreements. At the time of the "clean" opinion E&Y also already knew that AOL was recognizing revenue not permitted to be recognized under GAAP in connection with "barter" or "round trip" agreements with at least a dozen customers under which AOL recognized $182,000,000 in revenue during the quarterly periods ended 9/30/99, 12/31/99 and 3/31/00.

E&Y knew of AOL and AOLTW's round-tripping schemes, in which AOLTW funded its own revenue streams by providing cash to its customers to allow them to buy advertising from AOL. For example, E&Y knew that AOLTW had agreed to a round trip arrangement whereby AOL amended its AOL-Europe Put/Call Agreement with Bertelsmann (providing Bertelsmann with a $400 million benefit) in exchange for Bertelsmann's agreement to buy advertising. E&Y also allowed AOL and AOLTW to record revenue on barter transactions, even though, by AOLTW's own later admission, the Company utterly failed to comply with accounting standards governing revenue recognition on such transactions. Instead of putting a stop to this practice, E&Y instead deliberately ignored this ongoing GAAP violation but advised its client to try to keep the percentage of barter revenue under 10% of total advertising revenue so that the barter deals could be described as "immaterial" and so that AOLTW would have a pretext for not disclosing their terms.

In connection with the "clean" audit opinion contained in the MRS with respect AOL's financial results for the annual period ended 6/30/99, E&Y was required to make a "reasonable investigation" with respect to events at AOL subsequent to the date of the audit report up to 5/19/00, the effective date of the MRS. As such, E&Y is chargeable not only with the knowledge it obtained in connection with the 6/30/99 audit, but also its quarterly reviews from 9/30/99, 12/31/99 and 3/31/00. In those three quarters alone, E&Y reviewed at least twelve transactions where the impropriety of revenue recognition was readily apparent from the deal terms themselves. E&Y also permitted AOL to avoid disclosing in the MRS hundreds of millions of dollars in losses that would be incurred by AOL Europe, by permitting AOL to not consolidate the results of AOL Europe, even though GAAP required that the results be consolidated.

Pursuant to AU 711 E&Y's 5/19/00 consent letter to the inclusion of its 6/30/99 audit report constituted an affirmation that E&Y was not aware of any deviation from GAAP in not only AOL's 6/30/99 financial statements but also in the 9/30/99, 12/31/99 and 3/31/00 unaudited quarterly financials. E&Y was required to and did perform "subsequent events review procedures" between January and May 2000, during which reviews it became fully aware of AOL's non-GAAP accounting in connection with AOL Europe and its "round trip" arrangements with customers.

Based on this knowledge, E&Y should have, pursuant to AU 711, insisted on revision of the financial statements, modified its 6/30/99 report to describe the deviations, or withheld its consent to the inclusion of its audit report on the 6/30/99 financial statements in the Merger Registration Statement. It did not do so, but instead provided (and never withdrew) its clean opinion.

As the truth concerning AOL's false and misleading non-GAAP accounting practices (including "round tripping" of revenues, "barter" of advertising that was booked as revenue, and failure to consolidate the financial results of its international division AOL Europe) and false reported financial results for, *inter alia*, the quarterly periods ended 9/30/99, 12/31/00 and 3/31/00 was gradually revealed to the market, the value of AOLTW stock dropped as the price artificiality caused by the Company and E&Y's false and misleading statements dissipated. Specifically, the stock dropped $2.06 or 6.1% when *Barron's* reported concerning AOL/AOLTW's non-GAAP put-call agreement with European media conglomerate Bertelsmann AG. The stock also fell $0.80 or 4.1% on May 21, 2002 after the *USA Today* reported that bartering transactions involving AOL were being investigated by the SEC. When rumors swirled on June 25-27 2002 that AOLTW would have to restate its advertising revenues, AOLTW stock dropped a further $1.77 or 11.5%. These drops in AOLTW's share price took place at the times of disclosures concerning falsity of AOLTW's previously-reported financial state-

ments and/or potential non-GAAP nature of the accounting that E&Y had permitted and perpetuated via its knowingly false "clean" audit opinion in the MRS and failure to take the steps required under Generally Accepted Accounting Standards (GAAS) (including AU 711), and were statistically significant.

Plaintiff Amorosa read and specifically relied upon misstatements of material fact by E&Y as well as the Company. Were it not for these false and misleading statements, Amorosa would not have purchased AOL stock at artificially high prices and converted his AOL stock to AOLTW stock at an artificial exchange ratio, and would not have continued to hold his AOL and AOL Time Warner stock throughout the period January 2000 through August 2002.

REASONS FOR GRANTING THE WRIT

A. The Court Should Grant the Petition Because Courts' Interpretations of Two Near-Identical Statutory Phrases Concerning Misstatements "In Connection With" The Purchase or Sale of Securities With Respect to "Holder" Claims Are Significantly Inconsistent

The petition presents the question of whether the plaintiff, who purchased and later held AOL Inc. common stock based on alleged misrepresentations and omissions by defendants, can maintain a "holder" claim under the federal securities laws in light

of *Dabit v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 126 S.Ct 1503, 1513, 164 L.Ed.2d 179 (2006) (*"Dabit"*). *Dabit* held that the meaning of the statutory phrase "in connection with the purchase or sale of a covered security" in SLUSA was broad enough to preempt plaintiff's "holder" claims, because this language applies to any fraudulent conduct that *merely coincides with* a securities transaction. *Dabit*, 126 S. Ct. at 1514 [Emphasis supplied].

By contrast, courts have interpreted the nearly identical statutory phrase in Rule 10b-5 far more restrictively to prohibit an action by a "holder." Although it does not expressly hold as such, *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737-738, 95 S.Ct. 1917, 1926 (1975) (*"Blue Chip Stamps"*) has almost universally been read as requiring that a plaintiff actually engage in a purchase or sale (as opposed to a "hold") of a security *as a result of a misrepresentation or omission* in order to pursue a claim under Section 10(b) of the Securities Exchange Act. The *Blue Chip Stamps* Court expressly held that the phrase "in connection with" purchase or sale of a security language was not broad enough to cover persons who *never dealt in the subject security* but its holding did not address plaintiffs who allege that they *actually purchased and later* held stock based on defendant's misrepresentations or omissions- what is commonly referred to as a "holder" claim.

As these nearly identical statutory phrases have been interpreted by the courts in significantly

inconsistent manners applied to the same class of persons—putative plaintiffs who were "holders" of securities—the Court should reconcile this language and hold that a "holder" who alleges that he actually dealt in the subject security, and who affirmatively relied on misrepresentations and omissions, has alleged conduct that *coincides with* a securities transaction and can pursue a claim. *See Dabit,* 126 S. Ct. at 1514.

Although *Dabit* interpreted statute language providing that no covered class action arising out of "a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security" "may be maintained in any State or Federal court by any private party." 15 U.S.C. 78bb(f)(1)(A), its holding turned on the settled meaning of the statutory phrase "in connection with", which the Court had previously confronted in the context of claims under other statutory provisions contained in the Securities Exchange Act. The *Dabit* Court held that the meaning of "in connection with the purchase or sale of a covered security" was broad enough to preempt "holder" claims, because this language applies to any fraudulent conduct that *coincides with* a securities transaction. *Dabit,* 126 S. Ct. at 1514 [Emphasis supplied].[3]

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[3] *Dabit* suggests that the interpretation urged by this Petition is consistent with this Court's previous constructions of the phrase "in connection with" in other cases, including in *U.S. v. O'Hagan,* 521 U.S. 642, 117 S.Ct. 2199, 138 L.Ed.2d 724 (1997). As the *Dabit* Court stated:

> Moreover, when this Court has sought to give meaning to the phrase in the context of 10(b) and Rule 10b-5, it has

This Petition asks that the Court consider taking the logical next step and applying this same interpretation of the statutory phrase "in connection with" to Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder. Such a holding would *not* require the Court to revisit the holding in the seminal *Blue Chip Stamps* case. The Second Circuit's *Birnbaum v. Newport Steel*[4] decision (as elucidated by this Court in *Blue Chip Stamps* at p. 723) eliminates three groups of potential plaintiffs from recovering under 10b-(5): (1) Persons who

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> espoused a broad interpretation. A narrow construction would not, as a matter of first impression, have been unreasonable; one might have concluded that an alleged fraud is "in connection with" a purchase or sale of securities only when the plaintiff himself was defrauded into purchasing or selling particular securities. After all, that was the interpretation adopted by the panel in the Birnbaum case. See 193 F.2d, at 464. But this Court, in early cases like *Superintendent of Ins. of N.Y. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 92 S.Ct. 165, 30 L.Ed.2d 128 (1971), and most recently in *SEC v. Zandford*, 535 U.S. 813, 820, 822, 122 S.Ct. 1899, 153 L.Ed.2d 1 (2002), has rejected that view. Under our precedents, it is enough that the fraud alleged "coincide" with a securities transaction-whether by the plaintiff or by someone else. *See O'Hagan*, 521 U.S., at 651, 117 S.Ct. 2199. The requisite showing, in other words, is "deception 'in connection with the purchase or sale of any security,' not deception of an identifiable purchaser or seller."

Id. at 658, 117 S.Ct. 2199.

The same rationale could and should apply equally to the interpretation of the phrase "in connection with" in Section 10(b) and Rule 10b-5.

[4] 193 F.2d 461 (1952).

claim that they would have purchased had the violation not occurred; (2) persons who held their securities as a result of the violation; and (3) "shareholders, creditors, and perhaps others related to an issuer who suffered loss in value of their investment due to corporate or insider activities in connection with the offer or sale of securities" which violate Rule 10b-(5). *See Blue Chip Stamps*, 421 U.S. 723, 737-738, 95 S.Ct. 1917, 1926 (1975); *see also Birnbaum*, 193 F.2d at 464 (Rule 10b-5 "extended protection only to the defrauded purchaser or seller.").

While *Birnbaum* by its terms clearly bars all three categories of plaintiffs from asserting claims under Rule 10b-5, *Blue Chip Stamps* limits the remedies of only the first (potentially nearly limitless) category of plaintiffs- those *who never dealt in the subject security*. *Blue Chip Stamps*, 421 U.S. at 725 (first sentence of opinion), 738. As one learned district court has recognized, there is no such policy reason so to limit the remedies of persons *who actually dealt in* the subject security. *See In re Alger, Columbia, Janus, MFS, One Group, Putnam Mut. Fund*, 320 F. Supp. 2d 352, 355 (D. Md. 2004) (Motz, J.) (the evil of a potentially limitless group of plaintiffs envisioned by the *Blue Chip Stamps* Court was not present because "the class of potential plaintiffs, although extremely large, is clearly definable: all persons who held shares in the affected mutual funds during the period in which the alleged wrongdoing occurred.").

The Petition should be granted so that the Court can eliminate this dissonance between the courts' interpretations of the near-identical statutory phrases in SLUSA and Section 10(b) of the Exchange Act (and Rule 10b-5 promulgated thereunder) containing the "in connection with" formulation and affecting important rights of investors to bring actions under the federal securities laws.

B. This Court Should Carry Out the Clear Intent of Congress by Clarifying that Individual Securities Lawsuits Are Not Preempted By SLUSA

The Petition presents the question of whether a plaintiff's state law claims are preempted by the Securities Litigation Uniform Standards Act of 1998 ("SLUSA") notwithstanding that plaintiff's individual "opt-out" case did not seek relief on behalf of more than 50 persons and was not consolidated or jointly prosecuted with the class action or any other opt-out actions. In fact, although the sprawling multidistrict litigation of which it was a part at one time involved over 100 separate actions, at the time of its dismissal plaintiff's case was the only remaining action arising out of the AOL Time Warner accounting fraud that was still pending. The scope of remedies available to individual "opt out" plaintiffs in the context of a multidistrict litigation is a recurring one that has arisen with increasing frequency in recent MDLs. *See, e.g., In re Worldcom Inc. Sec. Litig.*, 308 F. Supp. 2d 236, 246 (S.D.N.Y. 2004) *In re AOL Time Warner*

Inc. Sec. Litig., No. 02-CV-5575, 2006 WL 903236 At *1, n.2 (S.D.N.Y. Apr. 6, 2006).

The current state of the law risks scenarios under which a relatively arbitrary decision concerning whether to consolidate or coordinate various cases as part of a multidistrict litigation may be determinative of whether substantive legal claims asserted by an individual plaintiff are preempted or not. *Compare Sherman v. Bear Stearns Cos. Inc.*, S.D.N.Y. Dkt. No. 09-CV-8161 (RWS) (district court granted large opt-out's plaintiff's objection to consolidation due in part to concern that if the case were consolidated with class action, certain claims would be preempted) with *In re Bear, Stearns Cos. Sec. Derivative and ERISA Litig.*, No. 09-CV-778, 08-MDL-1963, 2009 BL 252494 (S.D.N.Y. Nov. 13, 2009) (denying opt-out plaintiffs' motion to not have their case consolidated with class action).

The problems that can arise from arbitrary or overly broad interpretation of SLUSA's preemption provisions are illustrated by the case at bar, in which the district court and the court of appeals misinterpreted or failed to apply the statute's plain language. In the case at bar, all other cases arising from the AOL Time Warner accounting fraud *had already been resolved at the time of the dismissal.* Thus, the plain language of SLUSA does not sweep up this individual action for damages as a preempted "covered class action." SLUSA defines a covered class action as, *inter alia*,

> [A]ny group of lawsuits filed in or pending in the same court and involving common issues of law or fact in which—
>
> (I) damages are sought on behalf of more than fifty persons; and
>
> (II) the lawsuits are joined, consolidated, or otherwise proceed as a single action for any purpose.

15 U.S.C. § 78bb(f)(5)(B).

A "covered class action" is a lawsuit in which damages are sought on behalf of more than 50 people. *Dabit*, 126 S. Ct. at 1512. This action seeks damages on behalf of only one person, Amorosa, and thus fails to meet the definition of "covered class action" under SLUSA.

Further, SLUSA does not apply herein because this action and the other actions assigned to the same district judge were never "joined, consolidated, or otherwise proceed[ing] as a single action for any purpose." No party ever moved for consolidation of this action and the other opt-out actions and there were no joint motions, pleadings or court appearances as in some other cases in which preemption has been found.

The decisions below result from statutory interpretation that strays from the plain meaning of the statutory language and instead attempts to carry out what a court perceives to be the purpose of Congress in enacting the legislation. This Court should grant this Petition to clarify that SLUSA's preemp-

tion language means exactly what it says – that actions that are joined, consolidated or proceeding as a single action are preempted, and strictly individual actions that merely arise out of the same general fact pattern as other cases are not.

Contrary to the conclusions of the courts below, this interpretation is not at odds with Congress's expressed intent in enacting SLUSA. Despite Congress's clear intention to sweepingly preempt state court class actions, the Congress clearly did not intend to preempt mere individual actions. As the text of SLUSA states:

> . . . [I]n order to prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of the Private Securities Litigation Reform Act of 1995, it is appropriate to enact national standards for securities class action lawsuits involving nationally traded securities, while preserving the appropriate enforcement powers of State securities regulators and *not changing the current treatment of individual lawsuits.*

Pub. L. No. 105-353, § 2(5) [Emphasis supplied].

Congress acted to eliminate what it perceived as abusive state court class actions and did not intend to preempt an individual case in federal court seeking to assert a pendent state law claim. District courts, in their understandable efforts to manage complex litigation efficiently, have sometimes overextended SLUSA preemption to apply even to

individual actions. This Court should grant the Petition to clarify that state law claims in individual actions are not preempted by SLUSA.

C. The Court Should Grant the Petition to Clarify What is Required to Plead Loss Causation Against Auditors, A Recurring Question that Has Led To Widely Divergent Case Law in the Circuit Courts

Third, and finally, this Petition presents the frequently-recurring question of what is required to state a claim for loss causation against an auditor in the context of the Exchange Act. This question has vexed the lower courts because alleged misstatements by auditors are frequently not the subject of a "mirror image" or "I'm a liar"-style corrective disclosure. The Circuit Courts of Appeals have enunciated varying and inconsistent standards for pleading loss causation in this frequently-arising factual context. *Compare* case at bar (Appendix, pp. 7a-8a, 46a-48a) *with Indiana State District Council v. Omnicare, Inc.*, 583 F.3d 935 (6th Cir. 2009); *Tricontinental Inds. Ltd. v. Pricewaterhouse Coopers, LLP*, 475 F.3d 824 (7th Cir. 2007); *Alaska Elec. Pension Fund v. Flowserve Corp.*, 572 F.3d 221, 233 (5th Cir. 2009); *Castellano v. Young & Rubicam*, 257 F.3d 171, 186 (2d Cir. 2001).

Here, plaintiff argued that single corrective disclosure that is a "mirror image" of the fraudulent omission or misstatement is not required under the Court's leading case, *Dura Pharmaceuticals, Inc. v.*

Broudo, 544 U.S. 336, 345, 125 S.Ct. 1627, 161 L.Ed.2d 577 (2005) ("*Dura Pharmaceuticals*"). *Dura Pharmaceuticals* made it clear that a plaintiff's loss must be caused by a drop in a stock price's value that is causally related to disclosures concerning the misrepresentation or omission that plaintiff claims is fraudulent. However, the court did not require that this disclosure come in the form of a "mirror image" of the alleged false statement, and instead stated that plaintiffs may demonstrate that they suffered economic loss as the "relevant truth begins to leak out" or as "the truth makes its way into the market place." *Id.* at 342-43.

Justice Breyer explained at oral argument in *Dura Pharmaceuticals* that inflation could come out in many different ways, not simply by a defendant's admission that "I'm a liar." Rather, inflation could "ooze[ ] out as earnings reports come in, but it has to come out." *See* transcript of oral argument in *Dura Pharmaceuticals*, *available* at http://www.supremecourtus.gov/oral_arguments/argumenttranscripts/03-932.pdf. pp. 38-39.

If the Petition is granted, petitioners will argue that the Court of Appeals decisions essentially requiring a "mirror image" corrective disclosure are incorrect under *Dura Pharmaceuticals*. Further, in the case at bar, E&Y's June 30, 1999 audit opinion was never withdrawn and AOL's 1999 financials were never restated, and therefore there could not have been a stock drop based on a "mirror image" disclosure that E&Y's audit opinion was

false and misleading. However, Amorosa alleges, *inter alia*, that AOLTW stock dropped when the SEC's investigation of "barter" transactions to which it was a party was revealed and when the accuracy and integrity of its reported financial results (and more specifically its purported revenue growth that was in fact based on recognition of revenue from non-cash sources in violation of GAAP) came into question.

Such a disclosure, which clearly caused the stock to drop and *touches upon the falsity of E&Y's statement or risks concealed by it*, should suffice for purposes of alleging loss causation under the commonsense standard enunciated by this Court in *Dura Pharmaceuticals*. Granting the Petition will provide the Court with an opportunity to clarify that a "mirror image" disclosure along the lines of "our audit opinion was knowingly false" is not required to establish loss causation in the context of deliberately false and misleading audit opinions.

CONCLUSION

For the foregoing reasons and authorities, the Petition for writ of certiorari should be granted.

Dated: New York, New York
May 3, 2011

LAW OFFICE OF
CHRISTOPHER J. GRAY, P.C.

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Counsel for Petitioners

APPENDIX

09-5270-cv (L)
Amorosa v. AOL Time Warner

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

SUMMARY ORDER

Rulings by summary order do not have precedential effect. Citation to a summary order filed on or after January 1, 2007, is permitted and is governed by Federal Rule of Appellate Procedure 32.1 and this court's Local Rule 32.1.1. When citing a summary order in a document filed with this court, a party must cite either the federal appendix or an electronic database (with the notation "summary order"). A party citing a summary order must serve a copy of it on any party not represented by counsel.

At a stated term of the United States Court of Appeals for the Second Circuit, held at the Daniel Patrick Moynihan United States Courthouse, 500 Pearl Street, in the City of New York, on the 2nd day of February, two thousand eleven.

PRESENT: JOHN M. WALKER, JR.,
CHESTER J. STRAUB,
ROBERT A. KATZMANN,
Circuit Judges.

No. 09-5270-CV (L); 10-699 (Con)

DOMINIC F. AMOROSA,
Plaintiff-Appellant,

CHRISTOPHER GRAY,
Non-Party-Appellant,

—*v*—

AOL TIME WARNER INC., AMERICAN ONLINE, INC., PAUL T. CAPPUCIO, STEPHEN M. CASE, DAVID M. COLBURN, ERIC KELLER, J. MICHAEL KELLY, GERALD M. LEVINE, KENNETH J. NOVACK, WAYNE H. PACE, ROBERT W. PITTMAN, STEPHEN E. RINDER, JOSEPH A. RIPP, TIME WARNER INC., formerly known as AOL TIME WARNER CABLE, INC., BERTELSMANN AG,
Defendants,

ERNST & YOUNG LLP,
Defendant-Appellee.

For Plaintiff-Appellant and Non-Party-Appellant: CHRISTOPHER J. GRAY, Law Offices of Christopher J. Gray, P.C., New York, NY

For Defendant-Appellee: BRUCE M. CORMIER (Robert B. Hubbell, Gibson Dunn & Crutcher LLP, Los Angeles, CA, *on the brief*) Ernst & Young LLP, Washington, DC

Appeal from the United States District Court for the Southern District of New York (McMahon, *J.*).

ON CONSIDERATION WHEREOF, IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that the judgment of the district court is **AFFIRMED**.

In these consolidated appeals, Plaintiff-Appellant Dominic F. Amorosa appeals from a final judgment entered on November 30, 2009 by the District Court of the Southern District of New York (McMahon, *J.*), granting defendant Ernst & Young's ("E&Y") motion to dismiss, and Non-Party-Appellant Christopher J. Gray appeals the district court's grant of E&Y's motion for sanctions pursuant to Rule 11 of the Federal Rules of Civil Procedure and the Private Securities Litigation Reform Act of 1995 ("PSLRA"). We assume the par-

ties' familiarity with the facts and procedural history of the case.

Amorosa purchased common stock in America Online ("AOL") prior to its merger with Time Warner Inc. After allegedly fraudulent accounting practices at AOL and the newly merged company AOL-Time Warner ("AOLTW") came to light, he brought suit, alleging (1) violations of Section 11 of the Securities Act of 1933 ("Securities Act"); (2) violations of Sections 14(a) and 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"); and (3) state law claims of aiding and abetting a breach of fiduciary duty, common law fraud, and aiding and abetting common law fraud. On appeal, Amorosa contends that the district court erred in (1) dismissing his Section 14(a) and 10(b) claims for failing to adequately plead loss causation; (2) dismissing his Section 11 claim as (a) time-barred and (b) lacking in merit because E&Y would be able to establish lack of loss causation as an affirmative defense; (3) dismissing Amorosa's federal "holder" claim, based on the theory that he retained securities based on E&Y's purported misrepresentations, as unavailable under federal law; and (4) finding that his state law claims were preempted by the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"). Gray contends that the district court abused its discretion in imposing sanctions under Rule 11.

We review *de novo* the district court's dismissal of Amorosa's complaint. *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 167 (2d Cir. 2005). This Court may "affirm the district court's judgment on any

ground appearing in the record, even if the ground is different from the one relied on by the district court." *ACEquip Ltd. v. Am. Eng'g Corp.*, 315 F.3d 151, 155 (2d Cir. 2003). We review the district court's rulings on sanctions pursuant to Rule 11 and the PSLRA for abuse of discretion. *Gurary v. Winehouse*, 235 F.3d 792, 798 (2d Cir. 2000).

We turn first to Amorosa's Section 14(a) and 10(b) claims. Section 14(a) of the Exchange Act provides that "[i]t shall be unlawful for any person, by use of the mails . . . or otherwise, in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 78l of this title." 15 U.S.C. § 78n(a). Rule 14a-9 provides that "[n]o solicitation subject to this regulation shall be made by means of any proxy statement . . . containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading. . . ." 17 C.F.R. § 240.14a-9(a).

Section 10(b) of the Exchange Act provides that no person or entity may, in connection with the purchase or sale of a security, "use or employ . . . any manipulative or deceptive device or contrivance in contravention of [a Securities and

Exchange Commission rule]." 15 U.S.C. § 78j(b). Rule 10b-5 makes it unlawful, in connection with the purchase or sale of a security, "(a) [t]o employ any device, scheme, or artifice to defraud, (b) [t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made . . . not misleading, or (c) [t]o engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person." 17 C.F.R. § 240.10b-5.

Amorosa claims that E&Y made false and misleading statements in a "clean" audit opinion of AOL's June 30, 1999 financial statement. For both his 14(a) and 10(b) claims, Amorosa has the burden of pleading and proving loss causation. *Grace v. Rosenstock*, 228 F.3d 40, 46-47 (2d Cir. 2000). For both claims, the district court concluded, based primarily on a previous district court's ruling on the same claims brought by other plaintiffs, *see In re AOL Time Warner, Inc. Sec. Litig.*, 503 F. Supp. 2d 666, 678-79 (S.D.N.Y. 2007), that Amorosa failed to allege a sufficient causal nexus between the purportedly false and misleading statements by E&Y and Amorosa's losses. On appeal, Amorosa argues that the district court erred because he has pleaded loss causation by showing that his stock lost value when AOLTW's share prices fell as information concerning AOLTW's accounting practices was gradually disseminated to the public.

> [A] misstatement or omission is the 'proximate cause' of an investment loss if the risk

> that caused the loss was within the zone of risk concealed by the misrepresentations and omissions alleged by a disappointed investor. Thus, to establish loss causation, 'a plaintiff must allege . . . that the *subject* of the fraudulent statement or omission was the cause of the actual loss suffered,' *i.e.*, that the misstatement or omission concealed something from the market that, when disclosed, negatively affected the value of the security.

Lentell, 396 F.3d at 173 (omission in original) (citation omitted) (quoting *Suez Equity Investors, L.P. v. Toronto-Dominion Bank*, 250 F.3d 87, 95 (2d Cir. 2001) (emphasis added in *Lentell*)).

Amorosa first contends, relying on *Dura Pharmaceuticals v. Broudo*, 544 U.S. 336 (2005), that the disclosure need not be a "mirror image" disclosure of the harm, but rather, mere "leaking out" of information that points to the misrepresentation is sufficient to be deemed a "corrective event" that affected the value of his securities. Here, however, the district court correctly noted that Amorosa has not alleged any corrective disclosure regarding E&Y's June 1999 audit opinion, as none of the events identified as corrective disclosures by Amorosa in his complaint addresses AOL's accounting practices or in any way implicates E&Y's audit opinion. Amorosa therefore cannot establish that any misstatement or omission in E&Y's audit opinion was revealed to the market resulting in a diminution in the value of his securities.

Moreover, we agree with the district court that Amorosa could not establish loss causation on a "materialization of the risk" theory. When relying on such a theory, a plaintiff must allege some specific misstatements or omissions made by the defendant that can be connected to the plaintiff's eventual economic loss. *See Lentell*, 396 F.3d at 173. As the district court concluded, however, Amorosa's complaint does "not refer to any misstatements by [E&Y] and fail[s] to connect any fraud at AOL during the relevant time period to the auditor itself." J.A. 610. Because Amorosa's complaint fails to identify specifically any misstatements or omissions and, in turn, the risk that was thereby concealed, Amorosa has failed to establish loss causation on a "materialization of the risk" theory.

We turn next to Amorosa's Section 11 claim. Section 11 of the Securities Act provides that, *inter alia*, any one who signed a Merger Registration Statement ("MRS"), was a director of or partner in the issuer at the time of filing, any accountant or appraiser involved in preparing or certifying the MRS, and any underwriter can be held liable if "any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading." 15 U.S.C. § 77k(a). Amorosa alleges that E&Y is liable for misstatements in the June 1999 audit opinion incorporated by reference in AOLTW's MRS, filed

with the Securities and Exchange Commission on February 11, 2000.

We agree with the district court that Amorosa's section 11 claim is either time-barred or fails for lack of loss causation. Claims under section 11 are barred if brought more than one year after actual or constructive notice of the claim. 15 U.S.C. § 77m. According to Amorosa's Second Amended Complaint, the first disclosure revealing E&Y's fraud was on January 12, 2001. The corrective disclosure date is the same as the constructive notice date for purposes of limitations. *Lentell*, 396 F.3d at 175 n.4. Amorosa did not file suit until May 29, 2003. His section 11 claim is thus time-barred. In support of the timeliness of his section 11 claim, Amorosa argues that the statute of limitations was not triggered until the *Washington Post* published a series of articles in July 2002 that revealed AOL's questionable accounting practices. If, however, we accept Amorosa's contention, his section 11 claim fails for lack of loss causation. Because AOLTW's share price went up between the date of the *Washington Post* articles and the date Amorosa filed suit, E&Y's alleged misstatement could not have resulted in any losses. The absence of loss causation is an affirmative defense to a section 11 claim, but it is here apparent from the face of the complaint. It is thus a proper basis on which to dismiss the claim. *See Pani v. Empire Blue Cross Blue Shield*, 152 F.3d 67, 74 (2d Cir. 1998) ("An affirmative defense may be raised by a pre-answer motion to dismiss under Rule 12(b)(6), without resort to

summary judgment procedure, if the defense appears on the face of the complaint.").

As to Amorosa's "holder" claim under federal law, this Court agrees with defendant that the Supreme Court did not announce in *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71 (2006), that Rule 10b-5 provided a cause of action for a "holder" claim. Indeed, the Supreme Court specifically indicated that it was not revisiting the limitation of standing to purchasers and sellers of securities that had been previously announced in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975). *See Dabit*, 547 U.S. at 88 n.13 ("[W]e do not here revisit the *Blue Chip Stamps* Court's understanding of the equities involved in limiting the availability of private remedies under federal law."). Subsequent decisions of this Court have reaffirmed that there is no "holder" claim under federal securities law. *See, e.g., Druck Corp. v. Macro Fund Ltd.*, 290 F. App'x 441, 445 (2d Cir. Aug. 26, 2008) (summary order) (affirming dismissal of 10b-5 claim on ground that plaintiff, as a mere "holder" of securities, lacked standing).

Finally, with respect to Amorosa's state law claims, the district court concluded that SLUSA preempted his state law claims. SLUSA was enacted to make "federal court the exclusive venue for class actions alleging fraud in the sale of certain covered securities and by mandating that such class actions be governed exclusively by federal law." *Lander v. Hartford Life & Annuity Ins. Co.*, 251 F.3d 101 (2d Cir. 2001). SLUSA defines a "covered class action" to include "any group of lawsuits

filed in or pending in the same court and involving common questions of law or fact, in which . . . damages are sought on behalf of more than 50 persons; and . . . the lawsuits are joined, consolidated, or otherwise proceed as a single action for any purpose." 15 U.S.C. § 78bb(f)(5)(B). For substantially the reasons set forth by the district court in its opinion, we agree that Amorosa's suit falls within the definition of a "covered class action" and thus SLUSA precludes his state law claims.

We turn next to Gray's challenge to the district court's imposition of sanctions. Rule 11 of the Federal Rules of Civil Procedure provides that, by presenting a complaint to the court, the attorney signing or filing it "certifies that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances . . . the claims, defenses, and other legal contentions are warranted by existing law or by a nonfrivolous argument for extending, modifying, or reversing existing law or for establishing new law; [and] the factual contentions have evidentiary support or, if specifically so identified, will likely have evidentiary support after a reasonable opportunity for further investigation or discovery." FED R. CIV. P. 11(b)(2)-(3).

Under the PSLRA, the district court is required to make specific findings regarding compliance by all parties and attorneys with Rule 11 in a case brought under the Exchange Act and mandates the imposition of sanctions if it determines that Rule 11 has been violated. 15 U.S.C. § 78u-4(c). If the court finds that Rule 11 has been violated, it

"adopts a rebuttable presumption that the appropriate sanction for a complaint that substantially fails to comply with Rule 11(b) 'is an award to the opposing party of the reasonable attorneys' fees and other expenses incurred in the action.'" *Simon DeBartolo Group, L.P. v. Richard E. Jacobs Group, Inc.*, 186 F.3d 157, 167 (2d Cir. 1999)) (quoting 15 U.S.C. § 78u-4(c)(3)(A)(ii)).

After reviewing the district court's decision for abuse of discretion, we identify no such abuse in the imposition of sanctions here and thus find no reason to disturb the district court's decision on appeal.

We have considered appellants' remaining arguments and find them to be without merit. Accordingly, for the reasons stated herein, the judgment of the district court is **AFFIRMED.**

FOR THE COURT:
CATHERINE O'HAGAN WOLFE, CLERK

[OVAL STAMP]
UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
/s/ Catherine O'Hagan Wolfe

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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03 CIV. 3902 (CM)

DOMINIC F. AMOROSA,

Plaintiff,

—against—

ERNST & YOUNG LLP,

Defendant.

[CORRECTED] DECISION AND ORDER
GRANTING DEFENDANT'S MOTION
TO DISMISS THE COMPLIANT
IN ITS ENTIRETY

McMahon, J.:

INTRODUCTION

Dominic F. Amorosa was a private investor who purchased common stock of America Online, Inc. ("AOL") prior to its merger with Time Warner, Inc. ("Time Warner"). As a pre-merger stockholder, Amorosa voted in favor of the merger, and on January 11, 2001, exchanged his shares at a one-to-one ratio for shares in the successor corporation, AOL Time Warner, Inc. ("AOLTW").

More than a year and a half after the merger, the *Washington Post* published a two-part series of articles exposing widespread fraud at AOL and its successor corporation. Shortly thereafter, AOLTW, its executives and auditors found themselves facing hundreds of lawsuits arising from some of the same accounting practices the *Washington Post* had detailed. Amorosa commenced this action, the last of those suits, on May 29, 2003, naming as defendants AOL, Time Warner, AOLTW, eleven individual executives, Bertelsman AG and auditor Ernst & Young LLP ("Ernst & Young"). Presently, only one defendant (Ernst & Young) remains in his suit. Amorosa's complaint as amended alleges that Ernst & Young as auditor to AOL, Time Warner and AOLTW engaged in fraud in violation of federal and state law when it issued audited financial statements approving of the company's faulty accounting, and that the auditor aided and abetted the company's fraud in violation of state laws. Ernst & Young has responded by filing the motions

sub judice; a 12(b)(6) motion to dismiss Amorosa's complaint and a motion for sanctions under Rule 11 alleging that Amorosa's claims are frivolous.

For the reasons set forth below, Ernst & Young's motion to dismiss is granted in its entirety. Its motion for sanctions is neither granted nor denied; however, Ernst & Young is directed to produce a reasonable estimate of the attorneys' fees it seeks in connection with its motion, and plaintiff's attorney is ordered to show cause why sanctions should not be imposed.

FACTS

Amorosa's Stock Purchases

AOL and Time Warner announced their intent to merge on January 10, 2000. (Second Am. Compl. ("SAC"), Nov. 14, 2007, ¶¶ 12, 70.) Over the next three days, Amorosa purchased 16,000 shares of pre-merger AOL common stock at allegedly inflated prices ranging from $61.89 to $65.88 per share. (*Id.* ¶ 5.)

Then, on May 19, 2000, AOL and Time Warner took the next step toward consummating a merger between the two companies by jointly filing a Merger Registration Statement ("MRS") with the Securities and Exchange Commission ("SEC"). (*Id.* ¶¶ 13-14, 86.) The MRS contained selected historical financial data and AOL's previous SEC filings for shareholders to review in determining whether to support the merger, including inter alia:

(1) AOL's 10-K for the fiscal year ended 06/30/99;
(2) AOL's 10-Qs for the quarterly periods ended 09/30/99, 12/31/99 and 03/31/00;
(3) AOL's 8-Ks dated 12/01/99, 12/21/99, 01/10/00, 03/17/00, 04/03/00, and 04/18/00.

Id. ¶¶ 15, 17, 21.) AOL's 06/30/99 10-K (the "June 1999 Opinion" or "06/30/99 Opinion") was the only audited financial statement incorporated into the MRS; the others were "reviewed and approved" but never "certified" by AOL's auditor, Ernst & Young. (*See id.* ¶ 18.) Additionally, between the filing of the MRS and the consummation of the merger, Ernst & Young approved two additional audited financial statements on June 30, 2000 (the "June 2000" or "06/30/2000 Opinion") and December 31, 2000 (the "December 2000 Opinion" or "12/31/2000 Opinion"). (*See* Ernst & Young Mem. of Law in Supp. of Mot. to Dismiss ("E&Y MTD"), Jan. 18, 2008, at 5 (citation omitted).) The fourth and final audited statement prepared by the auditor was released on December 31, 2001 ("December 2001 Opinion" or "12/31/2001 Opinion"). (*Id.*)

Four months after AOL and Time Warner had first filed the MRS with the SEC, Amorosa purchased an additional 330 shares of pre-merger AOL common stock at $54.56. (SAC ¶ 5.) One week later, on June 23, 2000, AOL and Time Warner shareholders approved the merger (*id.* ¶ 12), and approximately seven months later, in January 2001, Amorosa exchanged his shares of AOL common stock for 16,330 shares of AOLTW common stock (*id.*

¶ 5). Since that transaction, he has neither purchased nor sold any AOLTW stock. (*Id.*)

Ernst & Young's Involvement in the AOLTW Merger

Ernst & Young was the independent auditor for AOL, Time Warner and AOLTW at all relevant times prior to the AOLTW merger. (*Id.* ¶ 6.) As the independent auditor, Ernst & Young "audited and issued audit reports on the companies' year-end financial statements," including audit opinions for the years 1999-2001. (E&Y MTD at 5 (citation omitted).)

Amorosa alleges that Ernst & Young's wrongdoing stems from the auditor's role in approving certain false and misleading financial statements that were incorporated by reference into the MRS. Specifically, Amorosa alleges that AOL's June 1999 Opinion was audited and certified as "clean" by Ernst & Young, and AOL's interim results were reviewed and approved by the auditor. (SAC ¶¶ 18, 21.) A "clean unqualified opinion" indicates that the auditor has reviewed the company's financial statements in keeping with Generally Accepted Auditing Standards ("GAAS") and that the financial statements themselves comport with Generally Accepted Accounting Principles ("GAAP") (*Id.* ¶¶ 21.) However, Amorosa alleges that no financial statement prepared and reviewed by Ernst & Young should ever have been certified as "clean" because Ernst & Young knew that AOL was actually relying upon non-GAAP accounting methods to fraudulently book certain revenues and conceal losses. (*Id.*

¶¶ 37.) Specifically, Amorosa alleges that Ernst & Young ignored certain "red flags" between 1999 and 2001 (*id.* ¶¶ 32, 45) and that Ernst & Young's "audit workpapers" demonstrate that it "knew" of fraud and helped to conceal it by advising the company to "keep the percentage of barter revenue under 10% of total advertising revenue." (*Id.* ¶ 33.) Amorosa further alleges that Ernst & Young "failed to challenge" the company's accounting for a series of transactions (*id.* ¶ 34), even though the auditor "reviewed at least twelve transactions where the impropriety of revenue recognition was readily apparent" (*id.* ¶ 36).

Reports of the Fraud at AOL

According to Amorosa, throughout 2001 and 2002, scattered news reports began to expose AOL's improper accounting practices. Some—but not all—were directly related specifically to the company's booking of online advertising revenue. (*Id.* ¶¶ 22, 359.) The examples cited by Amorosa can be divided into four categories and include the following:

Reports Regarding AOL/AOLTW's Financial Health

- A January 12, 2001 *Bloomberg* article that stated: "some on Wall Street have grown skeptical that the new company [*AOLTW*] will be able to meet its own projected growth rates." (*Id.* ¶ 359(a) (internal quotations omitted).)

- A February 1, 2001 *Wall Street Journal* article reporting concerns that AOLTW might not meet its "aggressive" '01 financial targets following disappointing 4Q '00 results." (*Id.* ¶ 359(b).)
- A July 18, 2001, J.P. Morgan analyst report questioning AOLTW's ability to meet its aggressive post-Merger financial targets." (*Id.* ¶ 359(d) (internal quotations omitted).)
- On August 14, 2001, the *Washington Post* reported that AOLTW was "expected to announce a round of substantial layoffs at its online unit [AOL] soon." That same day, "Morgan Stanley reduced its financial targets for the company." (*Id.* ¶ 359(e) (internal quotations omitted).)
- A September 7, 2001 Lehman Brothers forecast for AOLTW that cut revenue projections in part due to "a softer environment and more tempered top line growth at AOL." (*Id.* ¶ 359(f) (internal quotations omitted).)
- An October 8, 2001 *Barron's* article addressing "AOLTW's ability to accelerate its aggressive financial targets." (*Id.* ¶ 359(g).)
- An October 17, 2001 Merrill Lynch downgrade of AOLTW stock "due to concerns about future advertising revenue and subscriber growth." (*Id.* ¶ 359(h).)
- A December 6, 2001 *Bloomberg* report speculating that AOL CEO Gerald Levin's resignation "may signal weakness" (*Id.* ¶ 359(i).)

- A December 7, 2001 Merrill Lynch report stating that AOLTW "may be hampered by slowing subscriber and advertising growth at its America Online unit." (*Id.* ¶ 359(j) (internal quotations omitted).)
- A December 10, 2001 analyst report downward estimates for the AOLTW segment, because "the AOL segment is at risk of continuing margin erosion, driven primarily by declining ad and commerce revenue." (*Id.* ¶ 359(k) (internal quotations omitted).)
- A February 20, 2002 Lehman Brothers downgrade of AOLTW stock, which cited as "key concerns" declining subscriber revenues and online advertising." (*Id.* ¶ 359(l).)
- A June 4, 2002 Lehman Brothers downward revision of AOL advertising revenue forecasts. (*Id.* ¶ 359(o).)

Reports of SEC Investigations

- A May 21, 2002 *USA Today* article that Amorosa alleges reported on an SEC investigation of AOL's accounting practices, including the SEC's inquiry into the company's "bartering" transactions. (*Id.* ¶ 359(n).)
- The July 25, 2002 "disclosure" of an SEC investigation regarding AOL's accounting practices, which Amorosa did not attribute to any source. (*Id.* ¶ 359(r).)

Reports of General Accounting "Problems"

- A July 11, 2001 *Fortune* article entitled "Do AOL's Ads Add Up — Critics Question the Numbers," which referred to "controversial sales tactics" and "accounting games." (*Id.* ¶ 359(c) (internal quotations omitted).)
- An April 11, 2002 *New York Post* article reporting that AOL "may have accounting problems." (*Id.* ¶ 359(m) (internal quotations omitted).)
- June 26, 2002 "rumors," which Amorosa did not attribute to any source, regarding the potential that AOL would restate its financial results. (*Id.* ¶ 359(p).)

Reports of Specific Financial Misstatements

- July 18 and 19, 2002 *Washington Post* articles regarding AOL's accounting manipulations, which identified "certain transactions from which AOL falsely recorded revenue." (*Id.* ¶ 359(q).)

Significantly, although Amorosa does specify a percentage by which he alleges the AOL/AOLTW stock dropped on the date of each of the above articles, his recollection of these news reports is slapdash at best. For example, although Amorosa alleges that *USA Today* "identified AOLTW as one company relying on [bartering] transaction[s]," the May 21, 2002 *USA Today* article does not actually identify AOLTW as having booked bartered transactions.

(*Compare* SAC ¶ 359(n) *with* Matt Krantz, *Regulators Look Closely at Bartering*, USA Today, May 21, 2002, at 3B.) More importantly, of the many reports cited by Amorosa, *only* the *Washington Post* articles that were published on July 18 and 19, 2002, identify specific transactions at AOL that Amorosa alleges to have been fraudulent. (*See generally* SAC ¶ 359.)

Financial Restatements

Within two weeks after the July 2002 *Washington Post* story, AOLTW had confirmed that it was the subject of both SEC and Department of Justice ("DOJ") investigations regarding its accounting practices. (*Id.* ¶ 240.) By October, AOLTW had announced that it would issue financial restatements to correct for material errors in its earlier accounting. (*Id.* ¶ 26.) AOLTW went on to file two additional restatements and inconsistencies (*id.*), and "ultimately, AOL admitted that its 3rdQ 00 through 2ndQ 02 results had been misstated," and restatements issued covering the period July 1, 2000, to June 30, 2002 (*id.* ¶ 340).

Procedural History and Related Cases

The Class Action

Not surprisingly, the various newspaper articles and reports trumpeting allegations of fraud at AOL portended widespread litigation. Amorosa's action is the last of these several hundred lawsuits that arose in the wake of the AOL Time Warner merger. *See generally In re AOL Time Warner, Inc. Sec. and*

"ERISA" Litig., 381 F. Supp. 2d 192 (S.D.N.Y. 2004) ("*AOL I*"); *In re AOL Time Warner, Inc. Sec. Litig.*, 503 F. Supp. 2d 666 (S.D.N.Y. 2007) ("*AOL II*"). The lawsuits filed spanned several jurisdictions and were consolidated into a multidistrict litigation before Judge Kram in the Southern District of New York, who certified the class on September 30, 2005. *See AOL II*, 503 F. Supp. 2d at 669.

Thereafter, "a number of parties opted out of the class and filed individual actions throughout the country." *AOL II*, 503 F. Supp. at 669. Approximately 200 of these plaintiffs (in thirty-five actions) were represented by the firm of Lerach, Coughlin, Stoia, Geller, Rudman & Robbins LLP (hereinafter the "Lerach Plaintiffs"). *Id.* The Lerach Plaintiffs filed their complaints throughout the first half of 2006. Their complaints were identical "with the exception of the plaintiffs listed therein and the state law claims asserted." *Id.* at 670 n.2. Accordingly, Judge Kram aggregated their complaints and adjudicated the claims collectively. *Id.* at 669.

In addition to the similarities among the various complaints filed by the Lerach Plaintiffs (hereinafter the "Lerach Complaint"), the Lerach Complaint was essentially identical to the main class action complaint (*see* Second Am. Consol. Class Action Compl. of Lead Pl. Minn. State Bd. of Inv.) (hereinafter the "Class Action Complaint"), In re AOL Time Warner, Inc. Sec. & "ERISA" Litig., 02 Civ. 5575 (02 MDL 1500), Aug. 21, 2004), with many allegations re-appearing verbatim or with

only superficial edits. (*Compare, e.g.*, Lerach Complaint ¶ 258(a)(ii) *with* Class Action Complaint ¶ 126 (describing the Homestore transaction); Lerach Complaint ¶ 258(b)(iii) *with* Class Action Complaint ¶ 149 (describing the Veritas transaction); Lerach Complaint ¶ 258(f)(i) *with* Class Action Complaint ¶ 141 (describing the Sun Microsystems transaction); Lerach Complaint ¶ 258(j) *with* Class Action Complaint ¶ 163 (describing the WorldCom transaction); Lerach Complaint ¶ 258(g)(ii) *with* Class Action Complaint ¶ 189 (describing the Oxygen Media transaction).

Amorosa's Complaint and the Litigation Stay

On May 29, 2003, Amorosa, who was not a part of the class action at that time, filed his lawsuit in federal court as a "related" case, which was then referred to Judge Kram. In explaining the relationship between his and the main class action, he described his "securities fraud allegations" as "*identical* to those made in the class action." (Civil Cover Sheet filed by Dominic F. Amorosa, Form JS-44 at 3, Amorosa v. AOL Time Warner, Inc., Inc., No. 03 Civ. 3902 (S.D.N.Y. May 29, 2003) (emphasis added).)

Two years later, Amorosa amended his complaint for the first time to reflect the allegations in the Class Action Complaint. His first amended complaint explicitly "incorporate[d] by reference ¶¶ 3 through 30, ¶¶ 33 through 47, and ¶¶ 54 through 670 of the Second Amended Consolidated Class Action Complaint"—the equivalent of 650 paragraphs (approximately 140 pages) of the Class

Action Complaint, which he also attached as Exhibit 1 to his complaint. (Amorosa First Am. Compl. ¶ 1, Amorosa v. AOL Time Warner, Inc., No. 03 Civ. 3902, (S.D.N.Y. Apr. 8, 2005.)

In light of the clear parallels between the various complaints filed in connection with the class action, the parties stipulated to a stay of Amorosa's federal action until the court could resolve a motion to amend the Class Action Complaint and motions to dismiss the complaint of Stichting Pensioenfonds ABP. *See* Order Granting Stay ("Order Granting Stay") at 1-2, Amorosa v. AOL Time Warner Inc., No. 03 Civ. 3902, (S.D.N.Y. Aug. 5, 2005). Stichting Pensioenfonds was not part of the Lerach group, but may have been included in the stipulation as emblematic of the larger set of opt out actions that were pending at the time.

The stipulation extended Ernst & Young's time to answer or move against the complaint to 30 days after resolution of certain motions. The agreement provided in relevant part that:

> Whereas plaintiff Dominic F. Amorosa ("Plaintiff") filed a First Amended Complaint (the "Complaint") in the above-captioned action on April 7, 2005; and
>
> . . .
>
> Whereas the Complaint is substantially similar in many respects to the second amended consolidated class complaint filed in *In re AOL Time Warner, Inc. Sec. & "ERISA" Litigation*, 02 MDL Docket No. 1500 (SWK), the related consolidated putative securities class

> action that is also currently pending before this Court ("the MRD Securities Litigation"); and
>
> Whereas the Complaint is also substantially similar in many respects to the amended complaint filed in *Stichting Pensioenfonds ABP v. AOL Time Warner Inc.*, 03 Civ. 4934 (SWK), a related individual securities action is also currently pending before this Court (the "Stichting Litigation"); and
>
> . . .
>
> Whereas Plaintiff and E&Y wish to avoid burdening the Court with duplicative briefing in the same or similar issues; and
>
> Whereas counsel for Plaintiff and counsel for E&Y have therefore agreed to extend E&Y's time in which to answer or move against the Complaint until thirty (30) days after the Court resolves the Motion to Amend [filed by the lead plaintiff in the MDL] and the Stichting Motions to Dismiss;
>
> Now therefore it is hereby stipulated and agreed . . . that E&Y's time in which to answer or move against the Complaint is hereby extended to and including thirty (30) days after the Court resolved the Motion to Amend and the Stichting Motions to Dismiss.

Id. (internal quotations omitted).

Although defendant Ernst & Young originally argued that Amorosa had requested the litigation stay (*see* E&Y MTD at 1), the parties now appear to

agree that the stay of his claim was initially proposed by AOLTW (*see* Ernst & Young Reply in Supp. of Mot. for Sanctions ("E&Y R11 Reply"), Mar. 3, 2008, at 3; Amorosa Mem. in Opp. to Mot. for Sanctions ("Amorosa R11 Opp."), Feb. 22, 2008, at 1.)

Almost one year after the stay was entered, the class action received final settlement approval, on April 25, 2006. On June 1, 2006, one week later, the Stichting Pensioenfonds ABP case was voluntarily dismissed.

By the time the settlements occurred, the Lerach Plaintiffs had joined the party before Judge Kram. Although the Court can find no record of any formal written stipulation extending the stay to the Lerach Plaintiffs, Ernst & Young took no action against Amorosa until Judge Kram partially denied a motion to dismiss the Lerach Plaintiffs' claims on June 02, 2007.

Resolution of the Motions to Dismiss the Lerach Plaintiffs' Complaints

On June 20, 2007, Judge Kram granted in part the motions to dismiss the Lerach Complaint, allowing the Lerach Plaintiffs' suit to proceed on narrow grounds. *See AOL II*, 503 F. Supp. 2d 666. Specifically, the Lerach Complaint had alleged: (1) various violations of state law; (2) auditor liability under Section 11 of the Securities Act of 1933 ("1933 Act" or "Securities Act"); (3) liability in connection with the purchase or sale of a security under Section 10(b) of the Securities Act of 1934

("1934 Act" or "Exchange Act"); (4) liability arising from the issuance of proxy statement under Section 14(a) of the 1934 Act; and (5) control person claims under Section 15 of the 1933 Act and Section 20(a) of the 1934 Act.

In adjudicating these claims, Judge Kram held:

- First, plaintiffs' state law claims were preempted by the Securities Litigation Uniform Standards Act ("SLUSA"), because the Lerach Plaintiffs had a formal, established relationship pursuant to which they were jointly litigating their claims; therefore, despite the fact that each Lerach Plaintiff filed a separate copy of the Lerach Complaint with different state law claims, the Lerach Plaintiffs could be considered a "covered class action" as that term is used in SLUSA. *Id.* at 671-72.
- Second, plaintiffs' Section 11 claims were partially dismissed due to pleading defects—that is, they were dismissed to the extent that the Section 11 claims were based upon anything other than a June 1999 Ernst & Young audit opinion. *Id.* at 674-75.
- Third, plaintiffs' Section 10(b) claim was dismissed to the extent that liability was premised on the June 1999 Ernst & Young audit opinion because the plaintiffs could not establish loss causation as required by the 1934 Act. Additionally, plaintiffs' recovery was circumscribed. The court denied recovery insofar as plaintiffs sought compen-

sation for losses sustained prior to publication of articles in the *Washington Post* on July 18 and 19, 2002, because as the court explained, these articles first exposed the fraud at AOL/AOLTW. Therefore, the plaintiffs could not have sustained losses arising from the fraud prior to July 18, the court opined, since the market was unaware of the fraud until then. *Id.* at 676-80.

- Fourth, plaintiffs' Section 14(a) claim was dismissed for failure to adequately plead loss causation relating to the proxy statement. *Id.*
- Fifth, plaintiffs' control person claims under Section 15 of the 1933 Act and Section 20(a) of the 1934 Act were dismissed for failure toplead that Ernst & Young had control over a primary violator, since the primary violators were employed at AOL and Ernst & Young exercised no control over AOL personnel. *Id.* at 674.
- Sixth, the Court also rested its dismissal of pre-merger shareholders' Section 10(b), 11 and 14(a) claims on the ground that plaintiffs had failed to "identify any alleged misstatements by [Ernst & Young] that would have been material to pre-merger AOL shareholders." *Id.* at 672.

Amorosa's Amended Complaint
and the Motions *Sub Judice*

Amorosa amended his complaint (for a second time) in November 2007, shortly after Judge Kram issued her opinion in *AOL II*. The stated purpose of the amendment was to accommodate the new pleading standard governing loss causation announced by the Supreme Court in *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336 (2005), which was decided during the pendency of the motion to dismiss the Lerach Complaint. (*See* Amorosa R11 Opp. at 2.)

As filed, Amorosa's second amended complaint included the following claims:

Claim 1: Violations of Section 11 of the 1933 Act;
Claim 2: Violations of Section 14(a) of the 1934 Act and Rule 14a-9;
Claim 3: Violations of Section 10(b) of the 1934 Act and Rule 10b-5;
Claim 4: Aiding and abetting a breach of fiduciary duty;
Claim 5: Common law fraud;
Claim 6: Aiding and abetting common law fraud.

(SAC ¶¶ 363-409.)

Amorosa acknowledges that his second amended complaint (and for that matter, his first amended complaint as well) bears a substantial likeness to the Lerach Complaint, and disputes only the scope of the similarities. (*See generally* Amorosa Mem. of Law in Opp. to Mot. to dismiss ("Amorosa MTD Opp."), Feb. 14, 2008; Amorosa Mem. in Supp. of

Mot. for Leave to Amend, Mar. 12, 2007, at 7.) As a practical matter, although Amorosa is represented by different counsel (Christopher J. Gray, P.C.) and otherwise has no formal relationship to the Lerach group, his second amended complaint is identical in all material respects to the complaint of the Lerach group. The two pleadings share literally hundreds of pages of identical content. (*Compare, e.g.*, SAC ¶ 113 *with Northwestern Mut. Life Found., Inc. First Am. Compl.* ("Lerach Compl."), May 4, 2006, ¶ 120; SAC ¶ 163 *with* Lerach Compl. ¶ 172; SAC ¶ 182 *with* Lerach Compl. ¶ 190; SAC ¶ 357 *with* Lerach Compl. ¶ 318.)

In light of Judge Kram's decision partially dismissing the Lerach Complaint, Ernst & Young filed the *sub judice* motion to dismiss Amorosa's second amended complaint since it was nearly identical to the Lerach Complaint, and moved for Rule 11 sanctions against Mr. Gray, Amorosa's attorney. Ernst & Young contends that Amorosa is a vexatious litigant pursuing clearly frivolous claims as evidenced inter alia by the fact that his complaint was literally "copied and pasted" from the Lerach Complaint, most which Judge Kram dismissed as meritless. (Ernst & Young Mem. in Supp. of Mot. for Sanctions ("E&Y R11 Mot."), Jan. 18, 2008, at 1-2.) Amorosa maintains that his claims are different from those asserted in the Lerach Complaint and suggests that this Court sua sponte impose sanctions upon Ernst & Young for factual misstatements, including a misrepresentation relating to who initially sought the 2005 litigation stay in this case. (*See generally* Amorosa R11 Opp.)

DISCUSSION

I. Standard of Review

In deciding a motion to dismiss pursuant to Rule 12(b)(6), the Court must liberally construe all claims, accept all factual allegations in the complaint as true, and draw all reasonable inferences in favor of the plaintiff. *See Cargo Partner AG v. Albatrans, Inc.*, 352 F.3d 41, 44 (2d Cir. 2003); *see also Roth v. Jennings*, 489 F.3d 499, 510 (2d Cir. 2007). The Court may also consider the full text of documents that are quoted in the complaint or documents that the plaintiff either possessed, or knew about and relied upon in bringing the suit. *Rothman v. Gregor*, 220 F.3d 81, 88-89 (2d Cir. 2000); *San Leandro Emerg. Med. Group Profit Sharing Plan v. Philip Morris Cos.*, 75 F.3d 801, 808 (2d Cir. 1996). And in addition to the facts alleged in the complaint, the Court may take judicial notice of public disclosure documents filed with the SEC, *Kramer v. Time Warner Inc.*, 937 F.2d 767, 774 (2d Cir. 1991), as well as "well publicized stock prices" for the securities in question, *Ganino v. Citizen Utils. Co.*, 228 F.3d 154, 167 n.8 (2d Cir. 2000); *see also In re Allied Capital Corp. Sec. Litig.*, No. 02 Civ. 3812, 2003 WL 1964184, at *3 (S.D.N.Y. Apr. 25, 2003) (citation omitted); *Fant v. Perelman*, No. 97 Civ. 8435, 1999 WL 199078, at *5 (S.D.N.Y. Apr. 9, 1999) (citations omitted).

To survive a motion to dismiss, "a complaint must contain sufficient factual matter . . . to 'state a claim to relief that is plausible on its face.'"

Aschcroft v. Iqbal, 129 S. Ct. 1937, 1949 (2009) (*quoting Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007)). "A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Id.* (*citing Twombly*, 550 U.S. at 556). "While a complaint attacked by a Rule 12(b)(6) motion to dismiss does not need detailed factual allegations, a plaintiff's obligation to provide the grounds of his entitlement to relief requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do." *Twombly*, 550 U.S. at 545 (internal quotations, citations, and alterations omitted). Thus, unless a plaintiff's well-pleaded allegations have "nudged [his] claims across the line from conceivable to plausible, [the plaintiff's] complaint must be dismissed." *Id.* at 570; *Iqbal*, 129 S. Ct. at 1950-51.

Claims sounding in fraud must also meet Rule 9(b)'s heightened pleading standard. *See* Fed. R. Civ. P. 9(b). To comply with Rule 9(b), a complainant "must: (1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent." *Lerner v. Fleet Bank, N.A.*, 459 F.3d 273, 290 (2d Cir. 2006) (*quoting Mills v. Polar Molecular Corp.*, 12 F.3d 1170, 1175 (2d Cir. 1993) (internal quotations omitted). Although Rule 9(b) provides that "intent, knowledge, and other conditions of mind may be averred generally," a plaintiff must allege sufficient facts to create a "strong

inference" of scienter. *Kalnit v. Eichler*, 264 F.3d 131, 137-38 (2d Cir. 2001).

Similarly, the Private Securities Litigation Reform Act of 1995, Pub. L. 104-67, 109 Stat. 737 (1995) (codified as amended in scattered sections of 15 U.S.C.) ("PSLRA"), requires a private plaintiff bringing claims under certain federal securities laws (including Sections 10(b) and 14(a)) to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2). To establish "strong inference" of scienter, as required by PSLRA, the inference must be such that a "reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 324 (2007). Plaintiffs may discharge their burden of pleading a strong inference of scienter under both the PSLRA and Rule 9(b) by alleging facts "(1) showing that the defendants had both motive and opportunity to commit the fraud or (2) constituting strong circumstantial evidence of conscious misbehavior or recklessness." *ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 99 (2d Cir. 2007) (citation omitted) (PSLRA); *accord AOL I*, 381 F. Supp. 2d at 213 (citations omitted) (Rule 9(b)).

II. Relevant Statements by the Auditor

As a threshold matter, an auditor's liability under the securities laws is limited to its release of

audited financial statements or other statements formally attributed to the auditor at the time of dissemination. *See Lattanzio v. Deloitte & Touche, LLP*, 476 F.3d 147, 155 (2d Cir. 2007) (no liability under Section 10(b) for statements not attributed to the auditor); *see also Herman & MacLean v. Huddleston*, 459 U.S. 375, 381 n.11 (no liability under Section 11 for financials neither prepared nor certified by the accountant). In other words, an auditor's mere "review and approval" of a company's financial statements is wholly "insufficient to support the imposition of liability on the accountant." *Lattanzio*, 476 F.3d at 155 (citation omitted). Indeed, it is axiomatic that the auditor "can incur liability only if a misstatement is attributed to it at the time of dissemination." *Id.* (citation omitted).

Amorosa's Complaint refers to only four audited financial statements: (1) the June 1999 Opinion; (2) the June 2000 Opinion; (3) the December 2000 Opinion; and (4) the December 2001 Opinion. (E&Y MTD at 5 (citation omitted). Since only audited financial statements are formally attributable to an auditor at the time of their dissemination, these four opinions are the only documents that could possibly serve as the basis for Ernst & Young's liability under the 1933 and 1934 Acts. *See id.* at 155.

III. Amorosa's Securities Claims

Amorosa alleges that Ernst & Young violated Sections 14(a) and 10(b) of the 1934 Act as well as Section 11 of the 1933 Act. He further alleges that the auditor is liable under state law for fraud and

for aiding and abetting AOL/AOLTW's fraud and breaches of fiduciary duty by its directors. Amorosa's claims under Sections 14(a) and 10(b) of the 1934 Act are dismissed in their entirety because he has failed to plead loss causation adequately. Additionally, Amorosa's Section 11 claim is dismissed in its entirety because he fails to state a claim, and in any event, Amorosa's complaint makes clear that the auditor did not cause any losses suffered by the plaintiff. Further, this Court finds that Amorosa's state law claims are preempted by SLUSA.

A. Section 14(a) of the 1934 Act

Section 14(a) of the 1934 Act provides that "it shall be unlawful for any person by use of the mails . . . or otherwise . . . to solicit or permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 78/ of this title." 15 U.S.C. § 78n(a). "The purpose of [Section] 14(a) is to prevent management or others from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy solicitations." *J.I. Case Co. v. Borak*, 377 U.S. 426, 431 (1964), *abrogated on other grounds by Cort v. Ash*, 422 U.S. 66 (1975).

As Judge Kram explained in *AOL I*, of the four audited statements, only Ernst & Young's June 1999 Opinion could form the basis of a Section 14(a) claim against the auditor. 381 F. Supp. 2d at 241-42. For the same reasons, only the June 1999

Opinion could have formed the basis of liability in this case, because all other Ernst & Young audit opinions "post-dated the mailing of the Proxy/ Prospectus and the shareholder vote on the Merger," and therefore could not have functioned as a "solicitation" predicate to liability under Section 14(a) and the accompanying rules. *Id.* at 242 (*citing* 17 C.F.R. § 240.14a-1). However, Ernst & Young's June 1999 Opinion cannot actually serve as the basis of a Section 14(a) claim against the auditor here, because Amorosa does not adequately plead loss causation relating to that financial statement.

1. Loss Causation and the June 1999 Opinion

In order to state a claim under Section 14(a), the plaintiff bears the burden of pleading and proving loss causation, *Grace v. Rosenstock*, 228 F.3d 40, 46 (2d Cir. 2000) (citation omitted), which requires a plaintiff prove "both that the loss [was] foreseeable and that the loss [was] caused by the materialization of the concealed risk," *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 173 (2d Cir. 2005). In this context, the Second Circuit has explained that allegations regarding a security's inflated purchase price, without more, are insufficient to satisfy the loss causation requirement. *Emergent Capital Inv. Mgmt., LLC v. Stonepath Group, Inc.*, 343 F.3d 189, 198 (2d Cir. 2003).

The Second Circuit's loss causation jurisprudence comports with the Supreme Court's articulation of the loss causation requirement in *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336 (2005), wherein the Court held that a plaintiff pleading fraud

based upon an allegedly inflated purchase price must also allege that the price of the security "fell significantly after the truth became known" in order to state a claim under the federal securities laws. *Id.* at 347. Additionally, consonant with the requirements of *Dura Pharmaceuticals*, the Second Circuit has explained that in order to adequately plead loss causation, a complaint must at a minimum "allege facts that support an inference that the [defendant's] misstatements and omissions concealed the circumstances that bear upon the loss suffered such that plaintiffs would have been spared all or an ascertainable portion of that loss absent that fraud." *Lentell*, 396 F.3d at 175. Thus, for example, loss causation pleadings have been found to be sufficient where the plaintiffs "specifically asserted a causal connections between the concealed information . . . and the ultimate failure of the venture." *Emergent Capital*, 343 F.3d 198, and where the alleged misstatements were "the reason the transaction turned out to be a losing one." *First Nationwide Bank v. Gelt Funding Corp.*, 27 F.3d 763, 769 (2d Cir. 1994) (citing cases). In both of these cases, the loss causation allegations were sufficient because the pleadings specifically indicated that "the risk that caused the loss was within the zone of risk *concealed* by the misrepresentations and omissions." *Lentell*, 396 F.3d at 173 (emphasis in original).

By contrast, loss causation allegations are insufficient where they do not "speak to the relationship between the fraud and the loss of the investment." *Id.* at 174 (citing cases). For example, it is insuffi-

cient under the law of this Circuit to allege simply that a defendant's misstatements or omissions "induced a disparity between the price plaintiff paid for [securities] and their true investment quality." *Emergent Capital*, 343 F.3d 198 (internal quotations omitted). So is failing to "plead facts which, if proven, would show that [the] loss was caused by the alleged misstatements as opposed to intervening events" in a case where a plaintiff's alleged losses coincide with a marketwide phenomenon causing comparable losses to other investors. *First Nationwide Bank*, 27 F.3d at 772.

Further, in cases where, as here, a plaintiff seeks to hold a financial advisor or auditor responsible for primary violations of the securities laws, the plaintiff must plead that the market reacted negatively to some disclosure correcting the falsity in the advisor or auditor's statements (and not simply the underlying fraud). *See Lentell*, 396 F.3d at 175. Thus, in *Lentell*, loss causation was inadequately pleaded as against Merrill Lynch because "there [was] no allegation that the market reacted negatively to a corrective disclosure regarding the falsity in Merrill's 'buy' and 'accumulate' recommendations and no allegation that Merrill misstated or omitted risks that did lead to the loss." *Id.* (footnote omitted).

Analyzing loss causation under the Second Circuit's framework and as pleaded in the Lerach Complaint, Judge Kram in *AOL II* held that the June 1999 Opinion could not be the basis for imposing liability under Sections 10 and 14 because:

The plaintiffs do not allege that the 6/30/99 AOL Opinion was ever the subject of a corrective disclosure. In fact, the plaintiffs do not allege that the financial results certified by the Opinion were ever restated, or that the truth of that Opinion was called into question at any time during the AOLTW stock decline that caused their losses. Nor do the plaintiffs allege that the two allegedly fraudulent transactions entered into during that period were either corrected or brought to the market's attention prior to the stock's bottoming out at the end of July 2002. In short, the plaintiffs have not alleged that the market reacted negatively to the revelation of the 6/30/99 AOL Opinion's alleged falsity.

Furthermore, the plaintiffs cannot connect any of their losses to E & Y on a materialization of the risk theory, whether those losses purportedly arose out of the 6/30/99 AOL Opinion or out of any other allegedly false audit opinions. In each of these cases in which the Second Circuit has employed a materialization of the risk analysis, it has considered a particular risk that was allegedly concealed by the defendant's actions and which then materialized to cause a market loss . . . . Without providing some indication of the nature of the risk alleged, bare allegations that an undisclosed risk materialized to cause a plaintiff's loss are insufficient. Here, the plaintiffs do not ade-

> quately identify what risk was concealed by the allegedly false audit opinions, nor does the Court's scrutiny of the Complaint reveal the materialization of any risk that would be sufficient to plead loss causation.

503 F. Supp. 2d at 678 (citations omitted).

Amorosa now urges this Court to reject the reasoning of *AOL II* in light of certain revisions he has made to his complaint since the date of that decision. (Amorosa MTD Opp. at 14-18.) Specifically, he argues that, unlike the Lerach Plaintiffs, he "has pleaded what corrective disclosures occurred, where, and on what date, how much AOLTW stock dropped in price at the times of the corrective disclosures, and that each drop was statistically significant." (*Id.* at 14 (*citing* SAC ¶ 359).) But any difference between Amorosa's second amended complaint and the Lerach Complaint is superficial and insufficient to render Amorosa's allegations materially different from the Lerach Complaint.

Amorosa cites two paragraphs from his complaint that he believes differentiate it from the Lerach Complaint, though neither rehabilitates his pleadings. First, Amorosa points to a May 21, 2002 article in *USA Today*, which he alleges highlighted rumors regarding AOL's "sham" accounting. (*See* Amorosa MTD Opp. at 16 (*citing* SAC ¶ 359(n)).) Apart from Amorosa's failure to connect the article to the June 1999 Opinion, Judge Kram already held that any "disclosures" in this article were an insufficient basis on which to hang loss causation. *AOL II*, 503 F. Supp. 2d at 679. Moreover, Amorosa

completely misrepresents the content of that article, which mentioned the AOL-related transaction—a deal with SportsLine.com—but made no mention of AOL's accounting practices. Indeed, the mention of AOL in this article was entirely incidental; *USA Today* was actually reporting on the accounting practices of SportsLine (and others)—but not AOL. *See* Matt Krantz, *Regulators Look Closely at Bartering*, USA Today, May 21, 2002, at 3B. Further, the article is careful to point to that the "bartering" transactions it profiles are not necessarily illegal because "accounting rules stipulate it can be booked as revenue if a company collected cash for a similar deal in the past six months." *Id.* Since the article altogether fails to mention AOL's accounting practices, and in fact does not pass judgment on the legality of accounting practices it does mention, it cannot possibly be interpreted to have exposed any alleged fraud at AOL, and therefore cannot be relied upon to loss causation.

Second, Amorosa argues that he adequately pleaded loss causation because he alleged that "the 06/30/99 opinion was false and misleading in that it failed to reveal that the revenues reported therein included revenues from 'barter' transactions that should not have been permitted to be recognized at revenue under GAAP." (Amorosa MTD Opp. at 16 (*citing* SAC ¶ 30).) However, Amorosa still does not allege that the June 1999 Opinion was ever the subject of any corrective disclosure. *See AOL II*, 503 F. Supp. 2d at 678. He also fails to allege that the truth of the June 1999 Opinion was "called into question" at any time during the pur-

ported stock decline that arguably caused his losses. *See id.* Indeed, paragraph 30, which Amorosa relies on to substantiate his loss causation allegations, does not mention the June 1999 Opinion by name; does not mention any *audited* or *annual* financial statement (of which the June 1999 Opinion is one); and does not mention Ernst & Young or any other auditors. (*See* SAC ¶ 30). Rather, it simply states that "AOLTW violated Regulation S-X," by "fraudulently inflat[ing] reported revenue between Q3 1998 and Q2 2002 via barter deals . . . ." (*Id.*) If anything, paragraph 30 attributes misstatements *solely to AOLTW*. (*See id.*) This is understandable, as Amorosa's original complaint was brought against AOL, Time Warner, AOLTW and eleven of its executives.

As was the case with Merrill Lynch in *Lentell*, Amorosa has failed to allege, as required, that the market reacted negatively to some corrective disclosure regarding the falsity of statements made by Ernst & Young in its June 1999 Opinion. *See Lentell*, 396 F.3d at 175 (dismissing claim for failure to allege a negative reaction to Merrill Lynch's "buy" or "accumulate" recommendations). Thus, under the standard pronounced in *Lentell*, Amorosa's pleading as related to the June 1999 Opinion is insufficient to "support an inference" that Amorosa "would have been spared all or an ascertainable portion of [his] loss absent the fraud," if the June 1999 Opinion had not certified AOL's financial statements. Amorosa's Section 14(a) claim thus fails for lack of allegations relating to loss causation. *Id.*

B. Section 10(b)

Section 10(b) of the 1934 Act provides that no person or entity may, in connection with the purchase or sale of a security, "use or employ . . . any manipulative or deceptive device or contrivance" in contravention of an SEC rule. 15 U.S.C. § 78j(b). Rule 10b-5 makes it unlawful, in connection with the purchase or sale of a security, "(a) to employ any device, scheme, or artifice to defraud, (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made . . . not misleading, or (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit up on any person." 17 C.F.R. § 240.10b-5.

To establish liability under Section 10(b), the SEC must show that "in connection with the purchase or sale of a security the defendant, acting with scienter, made a material misrepresentation (or a material omission, if the defendant had a duty to speak) or used a fraudulent device." *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1467 (2d Cir. 1996) (citing cases). A misrepresentation is material if there is "a substantial likelihood that disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988) (citation omitted). Materiality generally presents a mixed question of law and fact. *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 450 (1976). Thus, a court should not grant a motion to dismiss "on the

grounds that the alleged misstatements or omissions are not material unless they are so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance." *Goldman v. Belden*, 754 F.2d 1059, 1067 (2d Cir. 1985).

1. Loss Causation and the June 2000 and December 2000 Ernst & Young Audit Opinions

In *AOL II*, Judge Kram held that any pre-merger misstatements or omissions were immaterial as a matter of law, because any "corrective disclosure" would only have redoubled AOL shareholders' resolve to consummate the AOLTW merger. *AOL II*, 503 F. Supp. 2d at 672-73. However, this Court finds it unnecessary to reach the question of materiality with respect to any alleged misstatements or omissions in the June 1999, June 2000 and December 2000 Opinions. Amorosa has failed to plead loss causation adequately with regard to any of these financial statements.

Amorosa had the burden of pleading and proving loss causation under Section 10(b). *See, e.g., In re Flag Telecom. Holdings Ltd. Sec. Litig.*, 574 F.3d 29, 40-41 (2d Cir. 2009). Amorosa's complaint in this respect is materially identical to the Lerach Complaint. He did not address facial deficiencies identified in *AOL II* when he amended his pleading; therefore, his Section 10(b) claim fails to the extent liability is premised on the June 1999 Opinion. *See supra* Part III.A.1.

As for later Ernst & Young opinions, Amorosa fails to allege that either the June or December 2000 Opinions were the subject of a corrective disclosure before he brought suit in May 2003, or that their truth was called into question at any time during the stock decline that he argues caused his losses. (*See* SAC ¶ 35 (financials for 2000 not restated until 2005).) Thus, although Amorosa does allege that the June and December 2000 Opinions, like June 1999 Opinion, contained Ernst & Young's unqualified certification that the financial statements were prepared in accordance with GAAP (*see* SAC ¶¶ 365-66), his failure to plead any facts which, if proven, would substantiate his assertion that Ernst & Young's certifications were indeed the cause of his losses is fatal to his claim.

The only allegations relating to Ernst & Young fail to establish a sufficient nexus between misstatements by the auditor arising specifically out of the June or December 2000 Opinions and losses alleged by the plaintiff. For example, Amorosa alleges that auditor ignored "red flags" between 1999 and 2001. (*Id.* ¶¶ 32, 45). This allegation is purely conclusory and mentions neither the June nor the December 2000 Opinions. Next, Amorosa alleges that Ernst & Young's "audit workpapers" demonstrate that it "knew" of fraud at AOLTW but that it failed to "put a stop" to the practice and instead advised the company to "keep the percentage of barter revenue under 10% of total advertising revenue." (*Id.* ¶ 33.) This allegation affords no basis for imputing liability to Ernst & Young, because AOLTW existed only *after* the merger.

Therefore, Ernst & Young's purported advice about AOLTW's accounting necessarily postdates the June and December 2000 Opinions (filed only on behalf of AOL) as well as Amorosa's share exchange (his last transaction involving AOL/AOLTW stock).

Amorosa's statements that Ernst & Young "allowed AOLTW to account for its interest in its European joint venture, AOL Europe, using a non-GAAP method of accounting" and "ignore[d] the fraudulent financial reporting" suffer from the same defect. (*Id.* ¶ 35; *see also id.* ¶ 44.) Insofar as this allegation relates to AOLTW, it postdates the merger and is therefore insufficient to suggest that there was fraud at AOL in the months prior to the merger. To the extent that the disclosure relates to AOL, Amorosa alleges that "the Company [not Ernst & Young] subsequently admitted in its second restatement in 2005, it should have consolidated the results of AOL-Europe's operations and recognized 100% of these losses." (*Id.* ¶ 35 (emphasis added).) Additionally, the fact that the restatement issued in 2005 suggests that any previous misstatements by the auditor that were corrected therein did not cause Amorosa's losses, since Amorosa brought suit in 2003, two years before the restatement issued.

Amorosa further alleges that the auditor "failed to challenge" the company's accounting for a series of transactions even though Ernst & Young "reviewed at least twelve transactions, where the impropriety of revenue recognition was readily apparent." (*Id.* ¶ 36; *see also id.* ¶ 34.) This allega-

tion does not reference any specific transactions, and fails to mention the December 2000 Opinion (or any related financial statements). It also fails to include any date by which the auditor should have challenged AOL's accounting, and omits reference to the specific accounting "problems" of which the auditor should have been aware; therefore, it provides no nexus between any purported fraud and the losses allegedly suffered by the plaintiff.

Amorosa's allegations do not include facts which, if proven, would establish that Ernst & Young could be held liable as a primary violator, because they do not refer to any misstatements by the auditor and fail to connect any fraud at AOL during the relevant time period to the auditor itself. As *Lentell* makes clear, Amorosa must identify specific statements implicating the auditor that casually relate in some way to the losses he alleged he suffered. *See* 396 F.3d at 175. Amorosa's failure to plead facts connecting specific statements made by the auditor to losses incurred by Amorosa is fatal to his Section 10(b) claim under the law of this Circuit. *See id.*

2. The Purchaser-Seller Limitation Under Federal Law

Amorosa tries to bootstrap his way into a Section 10 claim by arguing that the Supreme Court abandoned the "purchaser-seller" standing requirement in private securities actions in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71 (2006). (*See* Amorosa MTD Opp. at 19 (*citing*

Dabit).) If this were true, it would allow Amorosa to assert a federal claim as a "holder" of securities, based on any misrepresentations or omissions between the date on which he exchanged his AOL shares pursuant to the merger agreement (January 11, 2001) and the date on which he brought suit. (*See id.*) Actionable misstatements could have included, for example, Ernst & Young's fourth audited financial statement, the December 2001 Opinion.

Unfortunately for Amorosa, his interpretation of *Dabit* misconstrues its core holding and contradicts the plain language of the opinion.

The purchaser-seller limitation on the private right of action under the securities laws (Rule 10b-5) was first announced by the Second Circuit in *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir. 1952). In that case, the Second Circuit upheld the dismissal of a suit brought on behalf of a corporation alleging violations of Rule 10b-5 arising from fraud "in connection with" a director's sale of his controlling block of stock to third parties. *Id.* at 464. The Second Circuit explained that Rule 10b-5 could only be invoked by a "purchaser" or "seller" of securities to remedy fraud associated with an individual's transaction. *Id.* Therefore, Rule 10b-5 did not protect those who neither purchased nor sold the securities, but who were instead injured by the corporate insiders' sales to third parties. *Id.* Although many lower courts adopted the *Birnbaum* rationale, others continued to interpret the coverage of Rule 10b-5 more broadly. As a result, the Supreme Court was forced to revisit *Birnbaum* in

Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975). *See Dabit*, 547 U.S. at 80.

In *Blue Chip Stamps*, the Supreme Court "chose to limit the private remedy" afforded by Section 10(b) to purchasers and sellers. *Id.* As the Court explained in *Dabit*, "the main policy consideration tipping the scales in favor of precedent was the widespread recognition that 'litigation under Rule 10b-5 presents a danger to vexatiousness different in degree and in kind from that which accompanies litigation in general.'" *Id.* (*quoting Blue Chip Stamps*, 421 U.S. 732). Thus, the *Blue Chip Stamps* Court "relied chiefly, and candidly, on 'policy considerations' in adopting [the purchaser-seller] limitation." *Id.* at 84. (*quoting Blue Chip Stamps*, 421 U.S. at 737). In other words, as the *Dabit* Court explained, "The *Blue Chip Stamps* Court purported to define the scope of a private right of action under Rule 10b-5 *not* to define the words 'in connection with purchase or sale.'" *Id.* (*citing Blue Chip Stamps*, 421 U.S. at 749) (emphasis added). Indeed, the *Blue Chip Stamps* Court had noted that the statutory "in connection with" language did not speak "to the countours of a private cause of action" under the securities laws. 421 U.S. at 749.

By contrast, the Supreme Court in *Dabit* interpreted the statutory phrase, "'in connection with the purchase or sale,' as used in the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), Pub. L. No. 105-353, 112 Stat. 3227 (1998) (codified in part at 15 U.S.C. § 77v(a)). *See Dabit*, 547 U.S. at 85. Title I of SLUSA provides that "no covered class action" based on state law and alleging "a

misrepresentation or omission of material fact *in connection with* the purchase or sale of a covered security. . . . may be maintained in any State or Federal Court by any private party," 15 U.S.C. § 78bb(f)(1)(A) (emphasis added). In *Dabit*, the Supreme Court held that this language could be applied to preempt claims brought by holders of securities, not just purchasers or sellers. 547 U.S. at 85-87.

Section 10 and Rule 10b-5, like SLUSA, all employ the phrase "in connection with" the purchase or sale of a covered security. However, the Supreme Court in *Dabit* stated clearly that it did *not* purport to "revisit the *Blue Chip Stamps* Court's understanding of the equities involved in limiting the availability of private remedies under federal law." *Id.* at 88 n.13. That means a "holder" plaintiff continues to have no private right of action under Section 10(b) of the 1934 Act. Rather, the Court interpreted the phrase as consonant with the meaning afforded it in the two government enforcement actions, *SEC v. Zandford*, 535 U.S. 813, 820 (2002), and *United States v. O'Hagan*, 521 U.S. 642, 651 (1997). Those cases do not speak to the contours of a private right of action under the securities laws, as the actions were not brought by private litigants. *Dabit*'s holding interpreted only "Congress' intent in adopting a preemption provision, the evident purpose of which [was] to limit the availability of remedies under state law." *Dabit*, 547 U.S. at 88 n.13.

In this case, the practical impact of *Blue Chip Stamps* would be to limit Amorosa's cause of action of misstatements or omissions by Ernst & Young

that he could have relied upon in connection with his *purchase or sale* of stock (i.e., that are alleged to have occurred prior to the purchase and/or sale dates). These would include the June 1999, June 2000 and December 2000 Opinions, since Amorosa alleges that he purchased shares on two occasions prior to the merger: January 10 and June 23, 2000, and he exchanged ("sold") his shares for AOLTW common stock pursuant to the terms of the merger in January 2001. (SAC ¶ 5.) Since Amorosa has failed to adequately allege loss causation with respect to any of these opinions, *see supra* Parts III.A.1&B.1, he has failed to state a claim under Section 10(b).

C. Section 11

Amorosa, like the Lerach Plaintiffs, alleges that Ernst & Young is liable for misstatements contained in AOLTW's Merger Registration Statement ("MRS"), which was filed with SEC on February 11, 2000.

Section 11 of the 1933 Act provides that any signer, director of the issuer, preparing or certifying accountant, or underwriter may be liable if "any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state material fact required to be stated therein or necessary to make the statements therein not misleading. . . ." 15 U.S.C. § 77k(a). To state a claim under Section 11 of the 1933 Act, a plaintiff must show that a registration statement: "(1) contained an untrue statement of material fact; (2) omitted to state a

material fact required to be stated therein; or (3) omitted to state a material fact necessary to make the statement therein not misleading." *Caiafa v. Sea Containers Ltd.*, 525 F. Supp. 2d 398, 408 (S.D.N.Y. 2007) (internal quotations omitted).

Further, while "liability against the issuer of a security is virtually absolute, even for innocent misstatements," accountant liability under Section 11 (as with Section 10(b)) is limited to "those matters which purport to have been prepared or certified by them." *Herman & MacLean v. Huddleston*, 459 U.S. 375, 381 n.11 (1983) (*citing* 15 U.S.C. § 77k(a)(4)); *accord AOL II*, 503 F. Supp. 2d 675 n.8 (S.D.N.Y. 2007) (no liability under Section 11 for unaudited pro forma). Because only audit report included in the MRS is the audit opinion relating to AOL's June 30, 1999 financial statements, Judge Kram ruled in *AOL II* that the opinion in the June 30, 1999 financials was the only possible basis for imputing Section 11 liability to Ernst & Young. 503 F. Supp. 2d at 675. This Court agrees and adopts the same approach to Section 11 in reviewing Amorosa's second amended complaint.

There are two reasons why Amorosa's Section 11 claim must be dismissed. First, on the literal allegations of the complaint, it is time barred. While securities claims sounding in fraud must be brought the earlier of two years after discovery of the violation or five years after the violation itself, 28 U.S.C. § 1658(b), claims under Section 11, which sound in negligence (rather than fraud), are subject to a shorter statute of limitations. *In re Global Crossing Ltd. Sec. Litig.*, 313 F. Supp. 2d 189, 196

(S.D.N.Y. 2003). They must be brought "within one year after the discovery of the untrue statement or omission, or after such discovery should have been made by the exercise of reasonable diligence," and in any event, no later than three years after the securities in question were offered to the public. 15 U.S.C. § 77m. The securities in question were offered to the public at the latest on January 11, 2001, when the shareholders were invited to exchange their shares pursuant to the merger agreement between AOL and AOLTW; thus, the limitations period could terminate, at the latest, on January 11, 2004. However, where, as here, the one year discovery period ends prior to three years from January 11, 2001, the one year limitations period is applicable instead.

Amorosa alleges that the first corrective disclosure relating to AOL/AOLTW "fraud" occurred on January 12, 2001. If this allegation is true, then the fact that Amorosa waited almost two and a half years—until May 29, 2003—to file suit means that his claim falls outside the applicable limitations period. *See id.*

Alternatively, if the Court adopts Judge Kram's holding that any so-called "corrective disclosures" that occurred prior to July 18, 2002, failed to "establish a nexus between any of [Ernst & Young's] audit opinions and investment losses prior to July 18, 2002," *AOL II*, 503 F. Supp. 2d at 679, the complaint has to be dismissed because Amorosa suffered no losses during the period between July 18, 2002, and May 29, 2003, the date on which he commenced this action. The price of

AOLTW stock actually increased during that period.

In light of the Second Circuit's opinion in *Staehr v. The Hartford Fin. Serv. Group, Inc.*, 547 F.3d 406 (2d Cir. 2008), I agree with Judge Kram's conclusion that none of the earlier articles mentioned in the Lerach Complaint (or in Amorosa's) qualifies as a "corrective disclosure" of Ernst & Young's June 1999 Opinion, because none of them mentions the audit opinion or other misstatement attributable to Ernst & Young during the relevant time period, *see id.* at 415-16.

For example, Amorosa cites twelve articles published between January 2001 and June 2002, all of which discuss AOL's revenue projections and financial health. (*See* SAC ¶ 359.) None of these articles mentions the auditor or its June 1999 Opinion. (*See* SAC ¶ 359(a)&(b), (d)-(o).)

Plaintiff also cites three sets of alleged "disclosures" that address general accounting "problems" at AOL. (*Id.* ¶¶ 359(c), (m), (p).) These were: a July 11, 2001 article in *Fortune*, (*id.* ¶ 359(c)); the resignation of Barry Schuler, CEO of AOLTW's AOL unit, on April 10, 2002 (*id.* ¶ 359(m)); an April 11, 2002 *New York Post* article (*id.*); and "rumors" that "swirled" on June 25-27, 2002, regarding AOL's prospective restatement of its advertising revenues (*id.* ¶ 359(p)). Specifically, Amorosa states that:

> On June 25-27, 2002, rumors swirled that AOL was restating its advertising revenue. On June 26, 2002 concerns over the viability of cable stocks, rumors that AOLTW would pre-announce its second quarter results

> below expectations, and rumors that the Company might restate its financial results hit the market.

Id.

Judge Kram already ruled that the *Fortune* and *New York Post* stories cannot be deemed "corrective disclosures" because they did not include enough information to call Ernst & Young's June 1999 Opinion into question. *See AOL II*, 503 F. Supp. 2d at 678-80. Likewise, the resignation of Barry Schuler, in and of itself, is insufficient to support an allegation that the auditor's June 1999 Opinion contained misstatements or omissions. Further, the third set of disclosures—unattributed rumors regarding the possibility that AOL would restate its advertising revenues for some undisclosed dates—does not reference the June 1999 Opinion, and in any event, is not even linked to a media source. Such conclusory allegations are plainly insufficient.

Finally, Amorosa cites two reports that he says reveal SEC investigations of AOL. The first is a *USA Today* article on May 21, 2002, that allegedly "reported that the Securities [and] Exchange Commission ('SEC') was looking closely at 'bartering' transactions, and identified AOLTW as one company relying on this type of transaction." (*Id.* ¶ 339(n).) But the *USA Today* article does not actually say anything about AOL's accounting practices. *See supra* Part III.A.1.

The other "disclosure" is the conclusory statement that: "On July 25, 2002, it was disclosed that the SEC was investigating the accounting practices of AOLTW's AOL unit." (*See id.* ¶ 339(r).) Even if this disclosure did not post-date the July 18 and 19, 2002, *Washington Post* articles, it is clearly insufficient to serve as the basis for liability. While anonymous sources do not necessarily need to be identified, at a minimum, a plaintiff must provide descriptions of any unnamed sources sufficient to allow the court "to infer that the witnesses are likely to possess the information contained in their statements." *In re Xethanol Corp. Sec. Litig.*, No. 06 Civ. 10234, 2007 WL 2572088, at *3 n.3 (S.D.N.Y. Sept. 7, 2007); *accord Novak v. Kasaks*, 216 F.3d 300, 314 (2d Cir. 2000) (requiring plaintiffs to "supply sufficient facts to support their allegations" based on anonymous sources). Further, Amorosa's allegation provides an insufficient basis to support an inference that the information actually leaked into the market, since he has provided no source of publication for the alleged "disclosure." *See id.*

Amorosa tries to evade the force of this logic by noting that AOLTW's stock price dropped by a statistically significant amount after each of these articles appeared. (*See generally* SAC ¶ 359.) He further asserts—in wholly conclusory fashion (which this Court ignores on a motion to dismiss)—that the stock price occurred "due to news specific to AOLTW, and not explained by market or industry factors." (*Id.*)

It may be—indeed, it probably is—true that declines in the stock price of AOLTW that followed hard on the appearance of these articles can be attributed to the appearance of the articles. But that does not save plaintiffs Section 11 allegations. The fact of a drop in the stock price after the appearance of a news story, without more, is insufficient to give rise to an inference that Ernst & Young's negligence in certifying *the June* 1999 *financial statements* (as opposed to anything else) caused the stock price to drop—especially where, as here, there is no mention of Ernst & Young or the June 1999 audit opinion in any of the pre-July 18, 2002 articles mentioned in plaintiff's second amended complaint. Plaintiff's persistent failure to focus his "corrective disclosure" analysis pleading on purported misstatements by *Ernst & Young*—and, in the case of his Section 11 claim, on misstatements that were contained in one specific audit opinion, the June 1999 opinion—make it impossible to take that "analysis" seriously.

So the earliest "corrective disclosure" that could arguably be connected to the 1999 audit opinion is, as Judge Kram found, the *Washington Post* story that ran on July 18, 2002. And because that is the relevant corrective disclosure for Section 11 purposes, Amorosa's Section 11 claim is doomed because he suffered no losses following July 18, 2002.

It is true that in a Section 11 case, a court *presumes* that harm occurred based upon the alleged misstatement, and the defendant must rebut the presumption of loss before it can prevail. Loss cau-

sation is not an element of the cause of action under Section 11, so the plaintiff need not plead it, as he had to with claims brought under Sections 10(b) or 14(a). *See In re Giant Interactive Group, Inc. Sec. Litig.*, 643 F. Supp. 2d 562, 571 (S.D.N.Y. 2009) (citing cases).

However, where it is clear, from the pleading and from facts that can be judicially noticed (i.e., the stock prices on the relevant dates), that the plaintiff incurred all his losses in AOLTW *prior* to the date of the corrective disclosure (July 18, 2002), a plaintiff's Section 11 claim can and should be dismissed at the pleading stage. *See In re Merrill Lynch & Co., Inc. Research Reports Sec. Litig.*, 272 F. Supp. 2d 243, 253-55 (granting motion to dismiss).

In this case, AOLTW's stock price increased between July 18, 2002, and May 29, 2003. Therefore, it is clear from the face of the pleadings that plaintiff suffered no damages following the relevant corrective disclosure, and his Section 11 claim must be dismissed.[1]

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1 Judge Kram did not discuss lack of damage under Section II in *AOL II*, 503 F. Supp. 2d 666, probably because she was dealing with numerous complaints and the circumstances of each of the 200 Lerach Plaintiffs were different. But this issue disposes of Amorosa's Section 11 claim, and so causes me to reach a different conclusion than she did about the viability of the limited Section 11 claim that she recognized.

The fact that Amorosa's lack of damage is dispositive also makes it unnecessary to analyze whether the radical change in the standard for pleading a viable claim for relief under Rule 8-a change ushered in by the Supreme Court's opinions

IV. Plaintiff's State Law Claims Are Preempted by SLUSA

Ernst & Young also argues that Amorosa's state law claims for common law fraud, aiding and abetting common law fraud, and aiding and abetting breaches of fiduciary duty, should be dismissed because they are preempted by the SLUSA. (E&Y MTD at 12.) Ernst & Young argues in favor of preemption on the ground that Amorosa's action arises from "the same operative facts" as the Lerach Complaint that Judge Kram previously adjudicated. (*Id.* at 13.) In fact, Amorosa's complaint is identical in almost every way to the Lerach Complaint (and both are nearly identical to the main Class Action Complaint). And while Amorosa seeks damages for himself alone, if his case is aggregated with the cases brought by the Lerach Plaintiffs (or the main class action), all of the complaints considered collectively seek damages on behalf of more than 50 people. These facts are undisputed.

The parties disagree about whether Amorosa's suit can be considered a "covered class action" because it "proceed[ed] as a single action" with certain other plaintiffs' cases (including either the main class action or the lawsuits filed by the Lerach Plaintiffs). Ernst & Young argues that Amorosa's lawsuit proceeded as "a single action"

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in *Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007), and *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009), both of which postdate the issuance of *AOL II*, 503 F. Supp. 2d 666—would have caused Judge Kram to dismiss the Section 11 claim in the Lerach Complaint. It may well have.

with certain other opt-out plaintiffs' cases when Amorosa assented to a stay of litigation pending resolution of the motion to dismiss the class action complaint and that of one of those opt-outs. (*Id.* at 13-14) Ernst & Young notes that SLUSA must be interpreted broadly to effect the statute's remedial purpose, and under a broad reading, the Amorosa's lawsuit, the Lerach Plaintiffs' case and the main class action were functionally a single action because Amorosa "obtained the benefit of [ ] coordination" through the litigation stay. (*Id.* at 13.)

Ernst & Young also alleges that Amorosa's attorney, Christopher Gray, routinely engages in procedural shenanigans, pursuant to which he is able to circumvent the strictures of SLUSA by "requesting a stay of pleadings and discovery to allow for informal coordination without seeking formal joinder or consolidation." (*Id.* at 14.) Specifically, the auditor points out that in *Ventura v. AT&T Corp.*, No. 05 Civ. 5718, 2006 WL 2627979 (S.D.N.Y. Sept. 13,2006), Mr. Gray used upon a bad faith procedural strategy not unlike that at issue here. (*See id.*)

As set forth below, this Court agrees that Congress clearly intended SLUSA to preempt actions such as this, and Amorosa's state law claims are dismissed as preempted by SLUSA.

A. Background of SLUSA

SLUSA is one of a handful of securities statutes passed in the late nineties that were "intended to promote uniformity in the securities markets." *Lander v. Hartford Life & Annuity Ins. Co.*, 251

F.3d 101, 107 (2d Cir. 2001). It followed the Private Securities Litigation Reform Act of 1995 ("PSLRA"), which was enacted to curb so-called "strike suits"—meritless claims alleging fraud in the sale of securities. *Id.* (internal quotations omitted). Such suits were especially problematic because the expense of defending against such an action meant that issuers were often forced to settle, regardless of the merits of the action. *See id.* (*citing* H.R. Conf. Rep. No. 105-803 (1998)). In fact, one study of securities class actions published in the years before the PSLRA and SLUSA concluded that for practical purposes, the merits of a securities class action had no bearing on settlement outcomes. *See* Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 Stan. L. Rev. 497 (1991).

The PSLRA aimed to raise the pleading standards and instituting a mandatory stay of discovery "so that district courts could first determine the legal sufficiency of the claims in all securities class actions." *Lander*, 251 F.3d at 107 (citation omitted). However, by 1998, it became clear that litigants were regularly sidestepping the PSLRA's heightened pleading requirements by filing in state rather than federal court. *Id.* (citing Pub. L. No. 105-353 § 2(2)). Specifically, Congress reported that the decrease in federal securities actions post-PSLRA corresponded with an almost identical surge in state court securities-related cases. *See id.* at 108 (*citing* H.R. Conf. Rep. No. 105-803 (1998)).

SLUSA was enacted to close this loophole. The statute's primary purpose was to make "federal

court the exclusive venue for class actions alleging fraud in the sale of certain covered securities and by mandating that such class actions be governed exclusively by federal law." *Id.* at 108 (*citing* 15 U.S.C. §§ 77p(b)-(c)). Accordingly, SLUSA's preemptive scope reaches "any group of lawsuits filed in or pending in the same court and involving common questions of law or fact, in which—(I) damages are sought on behalf of more than 50 persons; and (II) the lawsuits are joined, consolidated, or otherwise proceed as a single action for any purpose." 15 U.S.C. § 78bb(f)(5)(B)(ii).[2] And SLUSA mandates that no such "action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging . . . a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security." 15 U.S.C. § 78bb(f)(I)(A).

B. The Finding of SLUSA Preemption in *AOL II*

In *AOL II*, the Lerach Plaintiffs had argued that their state law claims should not be preempted by

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[2] SLUSA is codified in two separate sections of the federal securities laws, 15 U.S.C. § 77p (amending the Securities Act of 1933) and 15 U.S.C. § 78bb(f) (amending the Securities Exchange Act of 1934). Because SLUSA amended the 1933 and 1934 Acts in "substantially similar ways," *see Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71 (2006), for the sake of brevity and clarity, the Court's citations to relevant SLUSA provisions will be limited to the language amending the 1934 Act.

SLUSA because "none of the individual actions [brought] state law claims from any one state for more than 50 people." 503 F. Supp. at 672 (internal quotations omitted). Similarly, Amorosa argues here that the "plain language of SLUSA does *not* sweep [his] individual action for damages as a 'covered class action.'" (Amorosa MTD Opp. at 24 (emphasis in original).) In *AOL II*, Judge Kram explicitly rejected the same argument, noting that "this observation ignores the fact that the 'individual actions,'" once aggregated per SLUSA's instructions are a 'covered class action' for the purpose of SLUSA and are properly subject to the Act's limitations on mass actions." *AOL II*, 503 F. Supp. 2d at 672. Judge Kram further explained that to give *ad seriatim* treatment to otherwise essentially identical complaints would allow plaintiffs "through artful pleading . . . [to] avoid the clear precepts of SLUSA and its preemption of state law securities claims for damages." *Id.* (internal quotations and citation omitted). Thus, she flatly rejected the argument advanced by the Lerach Plaintiffs that they were entitled to "the benefits flowing from joint prosecution of their claims" without the strictures imposed by SLUSA. *Id.*

C. Relevant Precedent

Other courts in this District have not been shy to apply SLUSA to preempt state law claims when confronted with similar circumstances. For example, in *In re Worldcom, Inc. Sec. Litig.*, 308 F. Supp. 2d 236 (S.D.N.Y. 2004) ("*Worldcom I*"), Judge Cote

held that the state law claims of ten plaintiffs were preempted when they were transferred to the court where the main class action was pending, even though each of the plaintiffs sought damages on behalf of fewer than 50 people. *Id.* at 245. In so holding, she explained that the plaintiffs' actions considered collectively sought damages on behalf of more than 50 people, and the cases could be considered cumulatively because they "had proceed[ed] as a single action for any purpose" under SLUSA as evidenced in part by the fact that "the plaintiffs' court filings are exact replications or simple joinders to each others' papers." *Id.* at 246.

Similarly, in *Gordon Partners v. Blumenthal*, No. 02 Civ. 7377, 2007 WL 1438753 (S.D.N.Y. May 16, 2007), *aff'd*, 293 Fed. App'x 815 (2d Cir. 2008), Judge Kaplan approved of the magistrate's finding in that case that the group of lawsuits had proceeded "as a single action for any purpose" based upon the fact that they had been consolidated for pretrial purposes. *Gordon Partners v. Blumenthal*, No. 02 Civ, 7377, 2007 WL 431864 (S.D.N.Y. Feb. 9, 2007) at *18 (Magistrate Judge Peck's Report and Recommendation). Thus, although no single complaint in that case sought damages on behalf of more than 50 people, since the plaintiffs totaled more than 50 when the cases were aggregated, SLUSA was properly applied to bar state claims. *Id.*

In fact, it appears that only one court in this District has ever declined to apply SLUSA under circumstances akin to those presented here. *See Ventura v. AT&T Corp.*, No. 05 Civ. 5718, 2006 WL

2627979 (S.D.N.Y. Sept. 13, 2006) (Stanton, J.). In *Ventura*, the plaintiff investor brought claims for violations of sections 20(a) and 10(b) of the 1934 Act as well as various state law claims. *Id.* at *1. The plaintiff's factual allegations and his claims for violations of the securities laws in that case were "substantively identical to those in the first amended and consolidated class action complaint" in another case, *Leykin v. AT&T Corp.*, No. 02 Civ. 1765 (filed Feb. 24, 2005). *Id.* Subsequently, although the plaintiff's federal claims were ultimately dismissed for the same reasons that the federal securities claims in the *Leykin* class action were dismissed, *see id.* at *1-2 (citation omitted), Judge Stanton nevertheless held that the plaintiff's state law claims were not preempted by SLUSA because *Ventura* had been proceeding along "a separate procedural track." *Id.* at *1.

The two-page unpublished decision provides little detail about the basis of Judge Stanton's conclusion regarding the procedural posture of the cases. As a result is of limited directional value for other courts in this District. *Cf. Gordon*, 2007 WL 431864, at *18 (distinguishing *Ventura*). However, his holding does appear to have been based in part upon a stipulation and order postponing the defendants' time to respond to the complaint until thirty-days after the motions in the class action were resolved. *See Ventura*, 2006 WL 2627979 at *1. Although Amorosa and Ernst & Young are parties to a similar agreement in this case, even Amorosa concedes that *Ventura* "is inapposite" because its "procedural posture" was entirely different given a

series of appeals that prolonged and complicated that case, presumably mandating the litigation stay in that case. (Amorosa MTD Opp, at 9 n.1.)

Further, were the procedural posture of the case indistinguishable, Judge Stanton's holding in *Ventura* would eviscerate SLUSA's core provision, which defines a covered class action relevant part to include two or more "lawsuits [that] are joined, consolidated, or otherwise proceed as a single action *for any purpose*." 15 U.S.C. § 78bb(f)(5)(B)(ii)(II) (emphasis added). To interpret this language as covering only lawsuits that are formally "joined or consolidated" would be to render the statute's description of the latter category of covered actions –lawsuits that "otherwise proceed as a single action for any purpose" –entirely redundant. Such an interpretation would run counter to the canons of statutory construction, which require courts "to give effect, if possible, to every clause and word of a statute." *State St. Bank & Trust Co. v. Salovaara*, 326 F.3d 130, 139 (2d Cir. 2003) (internal quotations omitted). Additionally, the plain language of the statute itself clearly employs two disjunctives, "or" and "otherwise," in order to signal the introduction of a third category of covered actions. It is well-established that "where the statutory language provides a clear answer," the plain language of the statute governs and a court's task of statutory interpretation ends there. *Raila v. United States*, 355 F.3d 118, 120 (2d Cir. 2004). Accordingly, this Court holds that an action need not have been formally joined or consolidated with other actions in order to

be a "covered class action" and subject to SLUSA's preemption provision.

D. Amorosa's State Law Claims

While Amorosa's opt-out action was never formally coordinated or consolidated with that of the other opt-outs, as was the case in *Worldcom I*, 308 F. Supp. 2d at 239 (pretrial consolidation), it is unquestionably the case that Amorosa's action "proceeded as a single action" with the multidistrict litigation ("MDL") action assigned to Judge Kram. Indeed, Amorosa appears to have availed himself of every opportunity to ensure that this would occur.

First, he filed a civil cover sheet identifying his case as "related" to the main class action, explaining that his "allegations on the securities fraud claim [were] *identical* to those made in the class action." (Civil Cover Sheet filed by Dominic F. Amorosa, Form JS-44 at 3, Amorosa v. AOL Time Warner, Inc., No. 03 Civ. 3902 (S.D.N.Y. May 29, 2003) (emphasis added).) As a result, his case was assigned to Judge Kram who was handling all of the "related" AOLTW cases by order of the Judicial Panel on Multidistrict Litigation. The assignment of Amorosa's related case to Judge Kram, where it would necessarily be handled in coordination with the AOLTW cases—absent any objection by Amorosa—is enough to make Amorosa's action a "covered class action" as that term is used in SLUSA.

Several additional facts alone compel a finding that Amorosa's case falls under the ambit of SLUSA. He replaced his initial complaint with a first amended complaint that "incorporated by reference" more than 650 paragraphs (the equivalent of approximately 140 pages) from the "Second Amended Consolidated Class Action Complaint," which was the main class action complaint in the case. (*See* Amorosa First Am. Compl. ¶ 1, Amorosa v. AOL Time Warner, Inc. (S.D.N.Y. Apr. 8, 2005) (listing paragraphs from the Main Class Action Complaint).) Then, he agreed to stay proceedings in his action pending resolution of a motion to amend the Class Action Complaint and motions to dismiss Stichting Pensioenfonds ABP's opt-out complaint, on the ground that his complaint was—not surprisingly—"substantially similar" to both the main class action complaint and the opt-out's; Amorosa announced that he wished to avoid "burdening the Court with duplicative briefing on the same or similar issues." *See* Order Granting Stay at 2.

Further, not only was Amorosa's first amended complaint virtually identical to both the Lerach Complaint and the Class Action Complaint (most of which Amorosa's complaint incorporated by reference), but he sought leave to amend his complaint only *after* he had obtained the benefit of briefing on motions to dismiss the Lerach Complaint. And he amended his complaint (for a second time) *following* disposition of the Lerach Plaintiffs' claims. *See AOL II*, 503 F. Supp. 2d 666 (S.D.N.Y. 2007).

Amorosa's second amended complaint, which he filed after *AOL II*, contained literally hundreds of

pages of allegations that can only be explained as having been copied and pasted from the Lerach Complaint that Judge Kram had just dismissed. Amorosa states that he amended his complaint to reflect the Supreme Court's loss causation holding in *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336 (2005), which was decided during the pendency of the motion to dismiss the Lerach Complaint. (*See* Amorosa R11 Opp. at 2.) However, the amendments to his complaint were also presumably designed to accommodate Judge Kram's decision in *AOL II*, since her holding in that case also found the Lerach Complaint defective on grounds *other* than loss causation. And if Amorosa did not amend his pleading to attempt to accommodate Judge Kram's holdings in *AOL II*, then he has effectively conceded that his action was frivolous in light of the duplicative content between his and the Lerach Complaint.

Finally, although the litigation stay did not by its terms apply to the Lerach actions, which were sent to the Southern District of New York by the Judicial Panel on Multidistrict Litigation after Amorosa had entered into the stay, Ernst & Young took no action against Amorosa's complaint for a year and a half after the class action settled. That is, when Ernst & Young moved to dismiss the Lerach Complaint in June 2006, it did not simultaneously move to dismiss Amorosa's virtually identical complaint. Further, for ten months, there were no developments in the litigation as between Ernst & Young and Amorosa until March 2007, when Amorosa filed a motion for leave to amend his com-

plaint for a second time.

Thus, Amorosa's recent assertion that there was a total "lack of coordination" between his action and the others (Amorosa MTD Opp. at 25) rings hollow. His case was deferred pending the resolution of the class action and the Stichting Pensioenfonds opt-out, which indicates that Judge Kram was handling them in coordination with each other. Further, he obtained the benefit of coordination with both the main class action and the Lerach Plaintiffs' cases when he, among other things, filed a copy of the class action complaint as his first amended complaint and the Lerach Complaint as his second amended complaint.

SLUSA thus preempts Amorosa's state law claims. This disposes of the remainder of Mr. Amorosa's claims, and his complaint is dismissed in its entirety.

V. Sanctions

A. Legal Standard

Defendant has moved pursuant to Federal Rule of Civil Procedure 11 for an award of sanctions against Amorosa's attorney (Christopher J. Gray, P.C.), including its reasonable attorneys' fees and costs incurred in bringing this action. Rule 11(b) of the Federal Rules of Civil Procedure provides that:

> By presenting to the court a pleading, written motion, or other paper . . . an attorney or unrepresented party certifies that to the best of the person's knowledge, information, and

> belief, formed after an inquiry reasonable under the circumstances:
>
> (1) it is not being presented for any improper purpose, such as to harass or to cause unnecessary delay or needlessly increase in the cost of litigation;
>
> (2) the claims, defenses, and other legal contentions therein are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversing of existing law or for establishing new law;
>
> (3) the factual contentions have evidentiary support or, if specifically so identified, will likely have evidentiary support after a reasonable opportunity for further investigation or discovery; and
>
> (4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on belief or a lack of information or belief.

In actions asserting federal securities violations, Rule 11 must be read in conjunction with the PSLRA's sanction provisions, which state, in relevant part:

> (c) Sanctions for abusive litigation
>
> (1) Mandatory review by the court
>
> In any private action arising under this chapter, upon final adjudication of the action, the court shall include in the record specific findings regarding compliance by each party and

each attorney representing any party with each requirement of Rule 11(b) of the Federal Rules of Civil Procedure as to any complaint, responsive pleading, or dispositive motion.

(2) Mandatory sanctions

If the court makes a finding under paragraph (1) that a party or attorney violated any requirement of Rule 11(b) of the Federal Rules of Civil Procedure as to any complaint, responsive pleading, or dispositive motion, the court shall impose sanctions on such party or attorney in accordance with Rule 11 of the Federal Rules of Civil Procedure. Prior to making a finding that any party or attorney has violated Rule 11 of the Federal Rules of Civil Procedure, the court shall give such party or attorney notice and an opportunity to respond.

(3) Presumption in favor of attorneys' fees and costs

(A) In general

Subject to subparagraphs (B) and (C), for purposes of paragraph (2) [the mandatory sanctions provision], the court shall adopt a presumption that the appropriate sanction—

(i) for failure of any responsive pleading or dispositive motion to comply with any requirement of Rule 11 (b) of the Federal

Rules of Civil Procedure is an award to the opposing party of the reasonable attorneys' fees and other expenses incurred as a direct result of the violation; and

(ii) for substantial failure of any complaint to comply with any requirement of Rule 11(b) of the Federal Rules of Civil Procedure is an award to the opposing party of the reasonable attorneys' fees and other expenses incurred in the action.

(B) Rebuttal evidence

The presumption described in subparagraph (A) may be rebutted only upon proof by the party or attorney against whom sanctions are to be imposed that—

(i) the award of attorneys' fees and other expenses will impose an unreasonable burden on that party or attorney and would be unjust, and the failure to make such an award would not impose a greater burden on the party in whose favor sanctions are to be imposed; or

(ii) the violation of Rule 11(b) of the Federal Rules of Civil Procedure was de minimis.

(C) Sanctions

If the party or attorney against whom sanctions are to be imposed meets its burden under subparagraph (B), the court shall

> award the sanctions that the court deems appropriate pursuant to Rule 11 of the Federal Rules of Civil Procedure.

15 U.S.C. § 78u-4(c).

Thus, the PSLRA requires district courts, at the conclusion of private actions arising under federal securities laws, to make Rule 11 findings as to each party and each attorney. *See* 15 U.S.C. § 78u-4(c)(1); *see also Rombach v. Chang*, 355 F.3d 164, 178 (2d Cir. 2004). At that time, if the Court finds that a violation has occurred, the imposition of sanctions is mandatory. 15 U.S.C. § 78u-4(c)(2). The PSLRA removed the judicial discretion of Rule 11 ("the court *may* . . . impose sanctions") in favor of a rebuttal presumption: "Courts shall adopt a presumption that the appropriate sanction . . . for substantial failure of any complaint to comply with any requirement of Rule 11 . . . is an award to the opposing party of the reasonable attorneys' fees and other expenses incurred in the action." 15 U.S.C. § 78u-4(c)(3)(A)(ii) (emphasis added).

In *Gurary v. Nu-Tech Bio-Med, Inc.*, 303 F.3d 212 (2d Cir. 2002), the Second Circuit articulated a three-step sanction inquiry for district courts to follow in situations where a plaintiff, like Amorosa, has brought multiple claims. *See id.* at 223. First, the Court must determine whether frivolous claims have been brought. *Id.* Second, if such claims have been brought, the Court needs to determine whether non-frivolous claims have also been joined. *Id.* Third, the sanctions presumption may be rebutted if the Court determines that the violation

was either de minimis or if the violator can show that full sanctions would constitute an unreasonable burden. *Id.*

Amorosa's federal claims (which comprise half of his total claims) patently lack merit. It thus appears that Amorosa's filing failed to comply with Rule 11 and sanctions against Mr. Gray are warranted.

However, this Court has not had the benefit of any briefing on sanctions under the PSLRA. In fact, this Court has had very little substantive briefing on sanctions at all; the briefs that purport to address Rule 11 appear to have been little more than a pretense for ad hominem attacks. As a result, this Court lacks sufficient information to determine, for example, whether an imposition of attorneys' fees would be an unreasonable burden upon Mr. Gray, an issue this Court is required to make findings about under the PSLRA. *See id.*

Accordingly, the parties are ordered to provide a new round of briefing on sanctions on the following schedule: (1) Within 10 business days, Ernst & Young will provide an estimate of the reasonable attorneys' fees it seeks; (2) Within 10 business days of receipt of Ernst & Young's estimate, Mr. Gray will show cause (in 10 pages or less) why sanctions should not be imposed on him; his brief should address specifically, inter alia, whether the fees proposed by Ernst & Young would pose an unreasonable burden on him; (3) Within 5 business days of receipt of Mr. Gray's brief, Ernst & Young shall respond (in 10 pages or less) or notify this Court that it does not intend to file a response.

All briefs submitted by the parties must be professional, engage in substantive legal analysis, and comply with the individual rules of this Court. If either brief fails to meet this standard, as the parties' previous Rule 11 briefs did, this Court will not hesitate to strike that brief.

CONCLUSION

Defendant's motion to dismiss (Docket No. 11) is granted in its entirely. Defendant Ernst & Young is instructed produce an estimate of the reasonable attorneys' fees it seeks under Rule 11 within 10 business days of the date of this order. Plaintiff's attorney, Mr. Christopher Gray, is ordered to show cause (in 10 pages or less) why sanctions should not be imposed, and he should do so within 10 business days of receipt of the fee estimate. The Clerk of the Court should immediately remove the motion to dismiss (Docket No. 11) from the Court's outstanding motion list.

This constitutes the decision and order of this Court.

Dated: November 30, 2009
Corrected: January 20, 2010

/s/ [ILLEGIBLE SIGNATURE]
U.S.D.J.

BY FAX TO ALL COUNSEL